May 11, 2023

Pace Stock Broking Services Pvt. Ltd.: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Bank facilities	600.00	600.00	[ICRA]A (Stable); reaffirmed
Total	**600.00**	**600.00**	

**Instrument details are provided in Annexure I*

Rationale

While arriving at the rating, ICRA has taken a consolidated view of Pace Stock Broking Services Pvt. Ltd. (PSBSPL) and Pace Commodity Brokers Private Limited (PCBPL), given the strong operational linkages between the two entities with a common management, complementary product offerings, operational synergies and the management's intention to merge PCBPL's business base with PSBSPL. PSBSPL houses the equity and currency broking business while commodity broking is housed under PCBPL.

The rating reaffirmation factors in PSBSPL's experience in capital markets and securities broking and its healthy operational metrics. The rating also derives comfort from the Group's adequate capitalisation profile for the current scale of operations with negligible leverage of 0.03x on a net worth of Rs. 955.1 crore on a consolidated basis as on December 31, 2022 and the management's stated intent of maintaining prudent leverage, going forward as well. The Group's liquidity profile is adequate, supported by the healthy level of margin utilisation with the exchanges and the comfortable capital structure. The rating also factors in the improvement in PSBSPL's earnings profile over the years, mainly driven by the Group's arbitrage business with strong risk management systems, along with the increasing trend witnessed by broking income and net interest income. Nevertheless, the continuance of income from the arbitrage business would depend on the Group's ability to identify arbitrage opportunities, going forward as well.

The rating is constrained by the limited diversification in the revenue streams and the Group's sizeable arbitrage business, which exposes PSBSPL to market risks and volatile capital markets. The rating also considers the risks associated with the proprietary trading business. However, the stated intention of the management to not take directional calls, the sizeable net worth which provides a cushion to absorb possible future losses that may arise from the arbitrage business, PSBSPL's track record of consistently reporting trading gains amid adverse capital market conditions and its ability to operate with minimal external debt and a low gearing provide comfort.

PSBSPL employs simple arbitrage strategies, which are fully hedged, and has deployed adequate risk management systems to deal with the volatilities in the markets. ICRA also notes that PSBSPL is focussing on diversifying the Group's business and revenue profile and plans to grow the business in the retail broking operations. However, the impact of the same on the overall revenue mix would be visible over the medium term. The Group's liquidity profile is good, supported by the healthy level of margin utilisation with the exchanges, the sizeable arbitrage book, which can be liquidated whenever needed, and the comfortable capital structure.

Going forward, PSBSPL's ability to meaningfully diversify its revenue stream and maintain healthy earnings and subsequently better net worth accretion while constantly upgrading the risk management system for managing the portfolio and market risk would be a key rating consideration. Also, ICRA notes that while recent proposals by the Securities and Exchange Board of India (SEBI) are likely to lead to increased working capital requirements for brokers, the impact on PSBSPL is expected to be minimal.

Key rating drivers and their description

Credit strengths

Long track record of promoters in capital market related business – The Group has a long track record of over 27 years in the capital market segment with a presence in the equity, commodity, and currency broking segments. It caters to both retail and institutional clients, though the bulk of the business remains focussed on high-net-worth individual (HNI) clients. It operates through ~18 branches and has over 569 retail franchises across the country.

Healthy earnings profile – The Group has witnessed an improvement in its profitability on a year-on-year (YoY) basis with the net profit increasing to Rs. 173.0 crore in FY2022 from Rs. 144.5 crore in FY2021 (Rs. 32.2 crore in FY2020) and broking income rising to Rs. 67.8 crore in FY2022 from Rs. 54.1 crore in FY2021 (Rs. 28.4 crore in FY2020). This was largely on the back of income from the arbitrage business using market-neutral arbitrage strategies and supported by the improvement in the capital market environment to Rs. 343.0 crore in FY2022 from Rs. 287.1 crore in FY2021. Consequently, the return indicators improved with the return on assets (RoA) and return on equity (RoE) increasing to 14.3% and 23.2%, respectively, in FY2022 from 13.0% and 25.3%, respectively, in FY2021.

ICRA notes that there was some moderation in the profitability in 9M FY2023 with PSBSPL reporting a net profit of Rs. 120.5 crore and broking income of Rs. 31.4 crore. The marginal decline in profitability in 9M FY2022 with RoA and RoE of 11.9% and 18.0% (on a provisional basis), respectively, which is in line with industry trend. The Group's asset quality indicators have remained healthy with nil write-offs in the capital market segment. Going forward, its ability to maintain healthy profitability in this business and growth in the broking business would be important for an improvement in the overall credit profile.

Adequate capitalisation profile – Supported by good internal accruals, the Group reported an increase in its net worth to Rs. 835 crore as on March 31, 2022 (PY: Rs. 656 crore) and further to Rs. 955 crore as on December 31, 2022. Its capitalisation profile is adequate for the current scale of operations with a low gearing of 0.03x as on December 31, 2022 (on account of internal liabilities, i.e. debt from promoters) as there is no external debt. As on December 31, 2022, the company had an unencumbered cash and bank balance of Rs. 330.03 crore and liquid investments of Rs. 109 crore against nil fund-based borrowings. Further, it had an overdraft limit of Rs. 90 crore and drawable but unutilised lines of Rs. 120 crore, which are adequate to cover any short-term obligations if needed.

In ICRA's opinion, sizeable net worth, which provides cushion to absorb any impact on profitability that may arise from the business, and the company's ability to continue maintaining prudent capitalisation will remain key monitorables. ICRA expects the Group's gearing to remain low in the medium term with the management's stated intent of maintaining the consolidated leverage below 0.2x.

Credit challenges

Limited diversification in revenue stream with focus on arbitrage business – The Group is engaged in securities broking and strategy-based/arbitrage (proprietary) trading with proprietary trading accounting for a sizeable proportion of its earnings. ICRA also notes the risks associated with the proprietary trading business though it can be liquidated whenever needed. Moreover, the risk gets somewhat mitigated by the Group's diversified arbitrage strategies and the risk management systems for the mitigation of such risks such as scenario simulations, stress testing, etc. In 9M FY2023, proprietary trading income accounted for 75% of the Group's total income (71% in FY2022), while broking accounted for 12% (16% in FY2021), with net interest income and other fee-based income accounting for the balance. However, PSBSPL's track record of consistently reporting trading profits since inception (over 27 years), amid adverse capital market conditions and operating with minimal debt only from the promoters with no external debt and negligible gearing, demonstrates the Group's market-neutral arbitrage strategies backed by appropriate risk management systems.

While the Group registered a strong increase in the average daily turnover (ADTO) in the equity broking business, the scale of the broking business, in terms of revenues, remains limited. It is, nevertheless, supported by the concentration of transaction volumes in the low-yielding derivative segment and the lower share of the high-yielding cash segment. PSBSPL's broking income increased to Rs. 67.8 crore in FY2022 from Rs. 54.1 crore in FY2021, which demonstrates the management's focus on retail broking. However, it moderated to Rs. 31.4 crore in 9M FY2023, in line with industry trends. ICRA notes that the Group is in the process of scaling up its retail-based broking income to diversify the income stream. The company is focussing on rolling out an improved and upgraded retail platform along with increased focus on marketing initiatives to improve its brand visibility. Going forward, PSBSPL's ability to achieve meaningful diversification in its revenue stream would remain critical for a further improvement in its credit profile.

Volatile earnings profile due to arbitrage business, which is exposed to market risks – PSBSPL is engaged in market-neutral arbitrage trading strategies backed by appropriate risk management systems and further plans to operate a high frequency trading (HFT) algorithm-based desk in the near term. The proportion of capital to be employed for the HFT desk and the risk management measures adopted for the same will remain key monitorables. The proprietary trading business remains exposed to market risks. Thus, the variability of earnings remains high because of its significant dependence on capital markets. However, the Group's track record in this business and adequate net worth to absorb possible losses provide comfort. Also, PSBSPL has reported profits from the trading operations despite periods of extreme volatility during the past 21 years. It reported proprietary trading income of Rs. 343 crore in FY2022 (YoY growth of 19.5%) and Rs. 248 crore in 9M FY2023. Going forward, its ability to maintain a healthy track record in this business, while ensuring adequate scale-up in the risk management processes to manage the portfolio and market risks, would be important.

Liquidity position: Adequate

PSBSPL's liquidity remained adequate as on December 31, 2022. The primary liquidity requirement is for placing margins at the exchanges and managing working capital requirements in the proprietary trading business and fulfilling client margin requirements in the broking business. PSBSPL deployed an average margin of ~Rs. 761 crore at the exchanges (funded through own and client funds/securities) between April 2022 and December 2022. As on December 31, 2022, the company had an unencumbered cash and bank balance of Rs. 330.03 crore and liquid investments of Rs. 109 crore against nil fund-based borrowings. Further, it had an overdraft limit of Rs. 90 crore and drawable but unutilised lines Rs. 120 crore, which are adequate to cover any short-term debt obligations if required.

Rating sensitivities

Positive factors – ICRA could upgrade the rating on the Group's demonstrated ability to ramp up the scale of operations with a meaningful diversification in the revenue stream, sustain healthy performance in the trading business while ensuring adequate risk management measures, and maintain healthy capitalisation.

Negative factors – The rating could be downgraded if there is a deterioration in the Group's financial performance, liquidity profile and/or significant erosion of the net worth. Pressure on the rating could also arise in case of any change(s) in the regulatory environment, which may impact the Group's business operations and financial performance.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's credit rating methodology for broking entities ICRA's rating approach – Consolidation
Parent/Group support	Not Applicable
Consolidation/Standalone	Consolidation

About the company

PSBSPL and PCBPL are a combined brokerage house providing broking, distribution and depository services to individuals and corporates. It has a track record of over 27 years in capital markets. The entities are promoted by Mr. Atul Goel and Mr. Amit Goel. The principal business of the two entities is providing stockbroking services to corporates and individuals as well as conducting arbitrage business. PSBSPL is enlisted as a member of Bombay Stock Exchange (BSE), National Stock Exchange (NSE), Metropolitan Stock Exchange of India (MSEI), Multi Commodity Exchange of India (MCX) and National Commodity and Derivatives Exchange (NCDEX) while PCBPL is a member of MCX and NCDEX. The Group also holds depository registration with Central Depository Services Limited (CDSL).

PSBSPL and PCBPL reported a consolidated net profit of Rs. 121 crore on income of Rs. 332 crore in 9M FY2023 (provisional). In FY2022, the entities reported a combined net profit of Rs. 173 crore on total income of Rs. 483 crore against reported net profit of Rs. 144 crore on total income of Rs. 388 crore in FY2021. The Group's net worth stood at Rs. 955.1 crore as on December 31, 2022 on a provisional basis.

Key financial indicators (audited and consolidated)

PSBSPL and PCBPL	FY2020	FY2021	FY2022	9M FY2023*
	Audited	Audited	Audited	Provisional
Net brokerage income	28.4	54.1	67.8	31.4
Trading income	95.4	287.1	343.0	247.7
Other non-interest income	0.5	0.7	0.7	0.4
Net Interest income	24.3	24.3	20.8	24.3
Net operating income (NOI)	55.5	76.8	100.8	66.8
Total operating expenses	119.5	178.9	231.4	163.6
Profit before tax	38.8	193.2	232.8	161.4
Profit after tax (PAT)	32.2	144.5	173.0	120.5
Net worth	488.5	655.7	834.5	955.1
Borrowings	47.3	7.9	6.6	32.4
Gearing (times)	0.10	0.01	0.01	0.03
Cost-to-income ratio (incl. trading income)	79%	49%	52%	52%
Return on average net worth	7%	25%	23%	18%
PAT/NOI (incl. trading income)	21%	40%	39%	38%

*Source: Company, ICRA Research; * Provisional numbers; 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 (FY2024)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					May 11, 2023	NA	Mar 24, 2022	NA
1	**Bank facilities**	Long term	600	NA	**[ICRA]A (Stable)**	**NA**	**[ICRA]A (Stable)**	**NA**

Complexity level of the rated instrument

Instrument Name	Complexity Indicator
Bank facilities	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 (as on March 31, 2023)

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Bank facilities**	NA	NA	NA	375	[ICRA]A (Stable)
NA	**Bank facilities**	NA	NA	NA	95	[ICRA]A (Stable)
NA	**Bank facilities**	NA	NA	NA	50	[ICRA]A (Stable)
NA	**Bank facilities**	NA	NA	NA	50	[ICRA]A (Stable)
NA	**Unallocated**	NA	NA	NA	30	[ICRA]A (Stable)

Source: Company data

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis.

Company Name	Ownership	Consolidation Approach
Pace Stock Broking Services Pvt. Ltd.	Rated Entity	Full Consolidation
Pace Commodity Brokers Private Limited	100.00%	Full Consolidation

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Manushree Saggar
+91-124-4545 316
manushrees@icraindia.com

Arti Verma
+91 124 4545 313
arti.verma@icraindia.com

Rajat Kher
+91 124 4545 833
rajat.kher@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 2433 1084
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches