August 01, 2023

Sharekhan BNP Paribas Financial Services Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper (CP) programme	1,000.0	1,000.0	[ICRA]A1+; reaffirmed
Total	**1,000.0**	**1,000.0**	

**Instrument details are provided in Annexure I*

Rationale

ICRA has taken a consolidated view of Sharekhan Limited (SKL) and Sharekhan BNP Paribas Financial Services Limited (SBPFSL; a subsidiary of SKL), hereafter referred to as the SKL 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). While arriving at the rating, ICRA has favourably factored in BNPP's presence on SKL's board, its supervision and control over the Group's activities and the co-branding[1]. The rating also takes into account SKL's considerable track record in the equity broking business, its well-established position in retail broking and capital market related lending activities, and its adequate financial profile with adequate capitalisation and liquidity.

While 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. Also, SKL's leverage increased in the last two fiscals, given the increase in the loan book vis-à-vis the preceding period, and the higher working capital requirement amid the evolving regulatory landscape besides the hefty dividend payout in FY2021. Nevertheless, the Group's capitalisation level remains adequate. As of March 31, 2023, SKL's consolidated net worth stood at Rs. 1,703 crore with a consolidated gearing of 1.1 times[2] (which had peaked to ~1.4 times as of September 30, 2022).

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 maintain 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, wherein the Group has registered losses. The Group's discount broking arm is unlikely to break even in the near term. Given the regulatory changes, the Group is likely to reorganise its structure, whereby SBPFSL will cease to be a subsidiary of SKL and will be directly held by one of SKL's shareholders. This is unlikely to have an impact on the credit profile.

Key rating drivers and their description

Credit strengths

Strong parentage with strategic importance to BNPP – BNPP acquired a 100% stake in SKL 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 April 2023, the company had a nine-member board with five representatives from BNPP, who ensure that SKL's operations are aligned with the parent's operations and policies. Further, SKL's Chief Operating Officer (COO), who is from

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

[2] It is, however, noted that the adjusted leverage of the broking entity, i.e. Total debt (including non-fund based lines adjusted for fixed deposits placed for availing these lines)/Net worth as per LC Gupta formula, was 2.9 times

BNPP, ensures that the parent has regular supervision and control over the Group's activities. Moreover, certain management functions (such as risk and treasury) of SKL report directly to BNPP. The rating also factors in the Group's co-branding with BNPP, whereby SKL's logo and signage include 'By BNP Paribas' while SBPFSL shares its name with BNPP.

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 4,006 franchisees and ~150 branches as on March 31, 2023. It is a full-service stockbroking company, primarily engaged in the retail equity broking segment. SKL registered a ~63% increase in its average daily turnover (ADTO) in the futures & options (F&O) segment in FY2023 and its market share, in terms of volume, was 0.5%. SKL's cash ADTO, however, declined by 31% and its market share, in terms of volume, was 1.6% as of March 31, 2023. Apart from broking, SKL, along with its subsidiaries (including SBPFSL), is engaged in capital market related activities such as loan against shares (LAS) and employee stock ownership plan (ESOP) financing, portfolio management services and mutual fund distribution.

Adequate financial profile and capitalisation; however, net interest margin under pressure – The Group registered a healthy growth in revenues in FY2021 and FY2022 and reported its highest-ever profit after tax (PAT) of Rs. 265 crore in FY2022 (Rs. 214 crore in FY2021 and Rs. 101 crore in FY2020). However, geopolitical tensions and the adverse macro-economic outlook dampened investor sentiment in FY2023 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 dip in its financial performance in FY2023 with its PAT/net operating income ratio declining to 16.8% in FY2023 from 26.5% in FY2022, while the return on equity (RoE) moderated to 9.1% in FY2023 from 17.7% in FY2022 (13.6% in FY2021). Nonetheless, as of March 31, 2023, SKL's consolidated capitalisation profile remained adequate with a net worth of Rs. 1,703 crore and a gearing of 1.1 times after touching a peak of ~1.4 times as of September 30, 2022. 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 55-65% 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 LAS, initial public offering (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 remained tepid in FY2023. 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 margin trade funding (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 cash broking volumes, moderated to 1.6% in March 2023 from 2.6% in FY2019, while its share in F&O broking volumes moderated to 0.5% from 1.0% during this period. In order to level the playing field, the Group forayed into the discount broking business in FY2021, though this business has not gained the desired traction. The Group's discount broking segment reported a net loss of Rs. 23 crore in FY2023 (net loss of Rs. 17 crore in FY2022). 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. It requires funds for supporting its lending business and placing margins at the exchanges. As on March 31, 2023, the total margin placed at the exchanges was Rs. 3,497 crore, of which 34% was utilised at day end, while the peak month-end margin utilisation between October 2022 and March 2023 was ~50%.

Compared to the consolidated borrowings of about Rs. 2,425 crore, SKL (standalone level) had unencumbered cash & equivalents of Rs. 393 crore and unutilised fund-based bank lines of Rs. 725 crore, while SBPFSL had unencumbered cash & equivalents of Rs. 98 crore as on June 30, 2023. Fund-based bank lines aggregating Rs. 152 crore 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. 1,538 crore [MTF book of ~Rs. 1,004 crore (under SKL) and LAS book of ~Rs. 534 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.

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 March 31, 2023, the company had four subsidiaries and two stepdown subsidiaries, which are all enlisted in Annexure II.

About the company

SBPFSL is a wholly-owned subsidiary of SKL and is registered with the Reserve Bank of India (RBI) as a non-banking financial company (NBFC). It provides loans/finance to the retail clients of the Group under various products such as LAS and funding for IPO, follow-on public offer (FPO), rights issue and ESOP/employee stock purchase scheme (ESPS). As on March 31, 2023, SBPFSL's gross loan book was Rs. 717 crore.

SKL

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 March 31, 2023, its active client base was ~6.6 lakh and the broking volumes were primarily contributed by the franchises. As on March 31, 2023, the company had 4,006 franchisees and ~150 branches.

Key financial indicators (audited)

SKL – Consolidated	FY2021	FY2022	FY2023
Net brokerage	550	602	530
Net interest income	209	272	247
Distribution and other fee income	60	82	77
Net operating income (NOI)	860	997	899
Total operating expenses	568	637	684
Profit before tax (PBT)	288	357	210
Profit after tax (PAT)	214	265	151
Net worth	1,383	1,601	1,703
Borrowings	633	1,803	1,905
Gearing (times)	0.5	1.1	1.1
Cost-to-income ratio	66.1%	63.8%	76.1%
Return on net worth	13.6%	17.7%	9.1%
PAT/NOI	24.9%	26.5%	16.8%

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

SBPFSL	FY2021	FY2022	FY2023
Total income	103	141	91
Profit after tax	46	64	33
Net worth	488	552	560
Net loan book	638	1,117	712
Total assets	733	1,236	806
Return on assets	6.4%	6.5%	3.2%
Return on net worth	9.1%	12.3%	6.0%
Gross gearing (times)	0.5	1.2	0.4
Gross NPA	0.0%	0.0%	0.0%
Net NPA	0.0%	0.0%	0.0%
CRAR	66.4%	45.0%	65.0%

Source: Company, ICRA Research; 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 as of Jul 15, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023				Date & Rating in FY2022		Date & Rating in FY2021	
					Aug 01, 2023	Mar 29, 2023	Feb 03, 2023	Sep 22, 2022	Apr 26, 2022	Jun 18, 2021	May 20, 2021	Sep 10, 2020	Jul 31, 2020
1	**CP programme**	Short term	1,000.0	325.0	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
2	**CP (IPO finance) programme**	Short term	-	-	**-**	**[ICRA]A1+ withdrawn**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[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
INE550X14AA1	**Commercial paper**	Dec 12, 2022	8.57	Dec 12, 2023	150	[ICRA]A1+
INE550X14AD5	**Commercial paper**	May 09, 2023	7.50	Aug 08, 2023	150	[ICRA]A1+
INE550X14AE3	**Commercial paper**	Jun 05, 2023	7.20	Sep 04, 2023	25	[ICRA]A1+
NA	**Commercial paper***	-	-	7-365 days	675	[ICRA]A1+

*Source: Company; *Yet to be placed*

Annexure II: List of entities considered for consolidated analysis

	SKL Ownership	Consolidation Approach
Sharekhan Limited*	Holding Company	Full Consolidation
Sharekhan BNP Paribas Financial Services Limited	100% (rated entity)	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

**SKL proposes to hive off Sharekhan BNP Paribas Financial Services Limited and its step down subsidiaries, Sharekhan.com India Private Limited and Sharekhan Consultants Private Limited to Human Value Developers Private Limited (HVDPL). HVDPL is a wholly owned subsidiary of BNP Paribas (BNPP) and it holds 27% stake in SKL*

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