February 22, 2024(Revised)

Zerodha Capital Private Limited: [ICRA]AA- (Stable)/[ICRA]A1+ assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	100.0	[ICRA]AA- (Stable); assigned
Long-term/short-term bank lines – Others	100.0	[ICRA]AA- (Stable)/[ICRA]A1+; assigned
Total	200.0	

**Instrument details are provided in Annexure I*

Rationale

The assigned ratings factor in the strong promoter group of Zerodha Capital Private Limited (ZCPL), which is a part of Zerodha Group, and its synergies with the Group's broking franchise (Zerodha Broking Limited (ZBL), flagship entity of Zerodha Group). The shared brand name, common promoters and strategic importance to the Group strengthen ICRA's belief that ZCPL will receive adequate and timely support from its promoter group, as and when required. The ratings also factor in ZCPL's comfortable capitalisation, the improving profitability trajectory and adequate liquidity position. The ratings are, however, constrained by the modest scale and nascent stage of operations as well as the limited diversification in the liability mix.

ZCPL actively commenced lending against securities in 2021 and its loan book aggregated ~Rs. 120 crore as of December 31, 2023. The company primarily offers loan against securities (LAS) and endeavours to offer retail LAS with ticket sizes in the range of Rs. 0.25 lakh to Rs. 1 crore and a loan-to-value (LTV) of around 45% against the approved list of stocks and mutual funds. With the modest scaleup of operations in the retail LAS segment, ZCPL has witnessed an improvement in its profitability, though the same remains modest. In 9M FY2024, the company reported a net profit of Rs. 3.9 crore (return on assets (RoA) of 4.1%) compared to Rs. 2.8 crore in FY2023. The capitalisation profile is characterised by a net worth[1] of ~Rs. 157 crore and a gearing of 0.1x as of December 31, 2023. Although the gearing is expected to increase as the company scales up its operations, it is projected to remain comfortable (3-4x).

While assigning the ratings, ICRA has noted that ZCPL remains exposed to credit and market risks, given the nature of the underlying assets. In this regard, any adverse event in the capital markets could erode the value of the underlying collateral stocks. Nevertheless, comfort is drawn from the Group's established presence in the securities broking business and its understanding of the associated risks and risk management.

The Stable outlook on the long-term rating reflects ICRA's expectation that ZCPL will continue to benefit from the synergies arising from the Group's established franchise and track record in the capital markets. Moreover, timely and adequate support from the Group is envisaged to be forthcoming, which, coupled with the calibrated growth strategy, is expected to continue to support a comfortable capitalisation and profitability trajectory.

Key rating drivers and their description

Credit strengths

Strong promoter group – ZCPL, a non-deposit taking base layer retail non-banking financial company (NBFC), is a part of Zerodha Group. ZBL, closely held by the promoters, pioneered the discounting broking business model in India and has become the largest domestic stockbroker, in terms of earnings and trading volumes, and the second largest, in terms of active National Stock Exchange (NSE) clients. As of January 31, 2024, the Group's active NSE client base stood at 69.9 lakh, accounting for an

[1] *Including shareholding money pending for allotment*

18% market share of the industry-wide NSE active clients. The Group's flagship entity had reported a consolidated net profit of Rs. 2,904 crore in FY2023 with a return on net worth of 53%. The performance remains healthy in the current fiscal with a net profit of Rs. 1,554 crore and a return on net worth of 40.4% on a standalone basis in H1 FY2024. As of September 30, 2023, ZBL's capitalisation profile was characterised by a net worth of Rs. 8,441 crore and nil financial leverage.

ZBL, the Group's flagship entity, and ZCPL have the same ultimate promoters. The promoters are Directors on the boards of both companies. Additionally, some of ZBL's seasoned senior leaders hold board positions at ZCPL. The Group's promoters enjoy sizeable cash flows from the flagship business and have been investing in early-stage businesses in sectors such as fintech, edtech, and healthcare. Given the shared brand name, common promoters and the strategic importance to the Group, ICRA believes that ZCPL will receive adequate and timely support (financial as well as operational) from its promoter group, as and when required.

Synergies arising from access to a strong brand and franchise – ZCPL enjoys access to an established brand, i.e. Zerodha, which is associated with a wide customer base as reflected by the NSE active client base of the Group's broking franchise. The sizeable demat holdings of the large client base offer a large potential target segment for ZCPL. Since the commencement of lending operations, ZCPL has largely scaled up its loan book through lending within the Group's franchise. Operational synergies are expected to continue supporting the company in keeping its cost structure under control while scaling up, which can otherwise be high in a retail lending business. Moreover, comfort is drawn from the Group's established presence in capital markets and its understanding of the associated risks and risk management.

ZCPL endeavours to offer retail LAS with ticket sizes in the range of Rs. 0.25 lakh to Rs. 1 crore and LTV of around 45% against the approved list of stocks and mutual funds at a flat lending rate to all customers. The company's operations remain largely digital with low reliance on human intervention. In this regard, it is noted that the Group develops the technological platforms for its core operations in-house (through entities such as Zerodha Technology Private Limited). Following the demonstrated track record of developing technology platforms for the broking franchise, the Group has leveraged its experience to develop the core modules for the lending business.

Comfortable capitalisation and track record of profitable operations since inception – ZCPL's capitalisation is characterised by a net worth of ~Rs. 157 crore, a capital-to-risk weighted assets ratio (CRAR) of 105.1% and a gearing of 0.1x as of December 31, 2023 (provisional basis). Going forward, while the financial leverage is expected to witness an uptick with the scaleup in operations, it is likely to remain comfortable supported by internal accruals and equity infusions (if required) from the promoter group. As per the management's stated intent, the company plans to maintain a leverage of less than 4x over the medium term (3-4 years). Overall, timely and adequate financial support from the Group is expected to aid the calibrated scaleup of the operations while the capitalisation remains comfortable. Moreover, notwithstanding the modest scale of operations, ZCPL has maintained a track record of profitable operations since inception, supported by its frugal cost structure and negligible financial leverage. It reported a net profit of Rs. 3.9 crore (RoA of 4.1%) in 9M FY2024 compared to Rs. 2.8 crore in FY2023 (RoA of 4.5%) and Rs. 0.9 crore in FY2022 (RoA of 2.7%).

Credit challenges

Nascent stage of operations with modest scale – Leveraging its established presence in capital markets, the Group commenced lending against shares through ZCPL in 2021. Hence, the Group's track record in lending remains limited. Although ZCPL's loan book increased to Rs. 120 crore as of December 31, 2023, it remains modest. Going forward, in addition to lending to customers in the Zerodha ecosystem, it plans to cater to customers outside the Zerodha ecosystem. In this regard, the company's ability to ensure the healthy scaleup of the loan book while exercising good control on the asset quality will remain a key monitorable. ICRA notes that the asset quality has remained healthy with negligible credit costs since inception. As of December 31, 2023, the asset quality was under control with gross non-performing advances (GNPAs) of 0.1%.

With calibrated growth since the commencement of operations in 2021, ZCPL has largely relied on equity capital and unsecured loans from directors for scaling up the loan book till date. As debt capital requirement has been limited, the company has a borrowing relationship with only one lender. Going forward, its ability to expand its liability profile while borrowing at competitive rates would be imperative for scaling up the operations profitably. The funding requirement of the broking franchise remains limited with sizeable free net worth after adjusting for proprietary investments and margin placements at exchanges.

Dependence on capital markets and exposure to market and credit risks – ZCPL's loan book remains exposed to credit and market risks, given the nature of the underlying assets. Any adverse event in the capital markets could erode the value of the underlying collateral stocks. Further, the ratings remain susceptible to regulatory changes as well as technological risks, given the predominantly online presence and high reliance on technology-based operations.

Liquidity position: Adequate

ZCPL's liquidity position remains comfortable with an unencumbered cash and bank balance of Rs. 24 crore and mutual fund investment of Rs. 29 crore, as of December 31, 2023, compared to nil principal repayments till April 30, 2024 (debt outstanding of ~Rs. 15 crore). Going forward, as the dependence on borrowings increases, the company will endeavour to maintain liquidity equivalent to repayments falling due in the ensuing three months. ZCPL also enjoys financial flexibility as it is a part of Zerodha Group.

Rating sensitivities

Positive factors – Ability to significantly scale up the operations while demonstrating healthy asset quality and profitability, besides building a diversified resource profile while maintaining a comfortable capitalisation profile on a sustained basis Additionally, improvement in credit profile of flag ship entity of Zerodha Group i.e. ZBL would be imperative.

Negative factors – Material change in linkage with the Zerodha Group and/or a deterioration in the group's credit profile. Besides, weakening of capitalization profile due to aggressive growth and/or profitability pressures will be credit negative.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Financial Companies
Parent/Group support	ZCPL is a part of Zerodha Group (flagship entity is ZBL). The shared brand name, common promoters and the strategic importance to the Group strengthen ICRA's belief that ZCPL will receive adequate and timely support (financial as well as operational) from its promoter group, as and when required.
Consolidation/Standalone	Standalone

About the company

Zerodha Capital Private Limited (ZCPL), a Reserve Bank of India (RBI) registered non-deposit taking base layer retail NBFC, is a part of Zerodha Group (ZBL is the Group's flagship entity). ZCPL is primarily held by Straddle Capital Private Limited (98.9% stake), which is closely held by ZBL's promoters. ZCPL actively commenced lending operations in 2021. It offers retail LAS with ticket sizes in the range of Rs. 5 lakh to Rs. 1 crore and LTV of around 45% against the approved list of stocks and mutual funds at flat yields to all customers.

As of December 31, 2023, the company had a loan book of about Rs. 120 crore, largely comprising LAS (94%), besides loans extended to the employees of Zerodha Group (6%). On a provisional basis, ZCPL reported a net profit of Rs. 3.9 crore in 9M FY2024 on total income of Rs. 7.5 crore. As of December 31, 2023, its capitalisation profile was characterised by a net worth (including compulsorily convertible preference shares and shareholder money pending for allotment) of Rs. 157.4 crore and a gearing of 0.1x.

Promoted by Nithin Kamath and Nikhil Kamath, ZBL is the flagship entity of Zerodha Group and is closely held by the Kamath family. It is one of the leading domestic brokers, in terms of earnings, and the second largest in terms of active NSE clients. As of January 31, 2024, the Group's active NSE client base stood at 69.9 lakh, accounting for an 18% market share of the industry-wide NSE active clients. Supported by the enablement of technology, digital know your customer (KYC) process, internet and mobile penetration and rising financial awareness, ZBL has reported a sizeable increase in client base and earnings over the years. It reported a consolidated net profit of Rs. 2,904 crore in FY2023 with a return on net worth of 53%. The performance remains healthy in the current fiscal with a net profit of Rs. 1,554 crore and a return on net worth of 40.4% on a standalone basis in H1 FY2024. As of September 30, 2023, ZBL's capitalisation profile was characterised by a net worth of Rs. 8,441 crore and nil financial leverage.

Key financial indicators (audited)

Zerodha Capital Private Limited	FY2022	FY2023	9M FY2024*
Total income	1.9	5.4	7.5
PAT	0.9	2.8	3.9
Total managed assets	41.0	84.4	174.0
Return on managed assets	2.7%	4.5%	4.1%
Reported gearing (times)	0.0	0.1	0.1^
Gross stage 3	1.3%	7.2%	0.1%
CRAR	NA	NA	105.1%

*Source: Company, ICRA Research; *Unaudited numbers; All ratios as per ICRA's calculations; Amount in Rs. crore; ^ Includes shareholding money pending for allotment*

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
					Feb 22, 2024	-	-	-
1	Bank lines- others	Long/Short term	100	-	[ICRA]AA- (Stable)/ [ICRA]A1+	-	-	-
2	NCD programme	Long term	100.0	-	[ICRA]AA- (Stable)	-	-	-

**As of December 31, 2023; Yet to be availed/issued*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Very Simple*
Bank Lines	Very Simple

** Subject to change when the terms are finalised.*

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
NA	**NCD – Yet to be issued**	NA	NA	NA	100.00	[ICRA]AA- (Stable)
NA	**Bank lines – Others**	NA	NA	NA	100.00	[ICRA]AA- (Stable) /[ICRA]A1+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis – Not applicable

Corrigendum

Rationale dated February 22, 2024, has been revised with changes as below:

- The complexity indicator of “Non-Convertible Debenture” has been changed from “Not Applicable” to “Very Simple; subject to change when terms are finalised.”
- The complexity indicator of “Bank Lines” has been changed from “Not Applicable” to “Very Simple

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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.

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