

March 24, 2022

Pace Stock Broking Services Pvt. Ltd.: [ICRA]A (Stable) assigned

Summary of rating action

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

*Instrument details are provided in Annexure-1

Rationale

While assigning the rating, ICRA has taken a consolidated view of Pace Stock Broking Services Private Limited (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 factors in PSBSPL's experience in capital markets and securities broking and its healthy operational metrics. The ratings also derive comfort from the Group's adequate capitalisation profile for the current scale of operations with negligible leverage of 0.04x on a net worth of Rs. 812.9 crore on a consolidated basis as on December 31, 2021 and the management's stated intent of maintaining the consolidated leverage below 0.2x going forward as well. The Group's liquidity profile is adequate, supported by the healthy level of margin utilisation with the exchanges and the strong capital structure.

The rating also factors in the improvement in PSBSPL's earnings profile, majorly driven by the group's arbitrage business with strong risk management systems, along with the broking income and net interest income also witnessing an increasing trend. Nevertheless, the continuance of the income from arbitrage business would be dependent on group being able to identify arbitrage opportunities going forward as well. The rating is however constrained by the limited diversification in revenue streams and group's sizeable arbitrage business which exposes PSBSPL market risks and volatile capital markets. The rating also considers the risks associated with the proprietary trading business; however, the stated intention of management of not taking directional calls, the sizeable net-worth which provides the cushion to absorb the possible future losses that may arise from arbitrage business, the PSBSPL's track record in consistently reporting trading gains in the past years amid adverse capital market conditions and operating 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 focusing on diversifying the Group's business and revenue profile and plans to grow the business in the retail broking operations. However, the impact of this in 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 strong capital structure. Going forward, PSBSPL's ability to meaningfully diversify its revenue stream and maintain healthy earnings and subsequently better accretion in the net worth while constantly upgrading the risk management system for managing the portfolio and market risk would be a key rating consideration.

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 above 26 years in the capital market segment with presence in the equity, commodity and currency broking segments. It caters to both retail

and institutional clients, though the bulk of the business remains High Net worth Individuals (HNI) clients focused. It operates through ~18 branches and has over 638 retail franchises across the country.

Healthy earnings profile – The Group has witnessed an improvement in profitability on a year-on-year (YoY) basis to Rs. 144.20 crore and Rs. 148.6 crores in FY2021 and 9MFY2022 from Rs. 32.20 crore in FY2020 with growth in broking income supported by improving yields both in cash and F&O segments and incremental addition of new retail HNI clients to Rs. 55 crore and Rs. 53 crore in FY2021 and 9MFY2022 from Rs. 30.6 crore in FY2020. The revenue profile is also backed by income from arbitrage business using market neutral arbitrage strategies and supported by the improvement in the capital market environment to Rs. 287 crore and Rs. 252 crores in FY2021 and 9MFY2022 from Rs. 95 crore in FY2020. There was also growth in broking income supported by improving yields both in the cash and futures and options (F&O) segments and incremental addition of new retail HNI clients to Rs. 55 crore and Rs. 53 crore in FY2021 and 9MFY2022 from Rs. 30.6 crore in FY2020. Consequently, the return indicators improved with the return on assets (RoA) and return on equity (RoE) improving to 13.0% and 25.2%, respectively, in FY2021 from 3.5% and 6.7% in FY2020. It continued to report an improvement in profitability in 9M FY2022 with an RoA and RoE of 18.5% and 30.6% on a provisional basis. The group's asset quality indicators have remained healthy with nil write-offs in the capital market segment. Going forward, its ability to maintain a healthy profitability in this business and growth in broking business would be important.

Adequate capitalisation profile - Supported by good internal accruals, the Group reported an increase in the net worth to Rs. 656 crore as on March 31, 2021 (PY: Rs. 488 crore) and further to Rs. 813 crore as on December 31, 2021. The Group's capitalisation profile is adequate for the current scale of operations with a low gearing of 0.04 times as on December 31, 2021 (on account of internal liabilities i.e. debt from promoters) as there is no external debt. As on December 31, 2021, the company had Rs. 63 crore of un-encumbered cash and bank balances, Rs. 88 crore of liquid investments as against zero of fund-based borrowings. Moreover it had ~Rs. 160 crore of highly liquidable trading book and Rs. 138 crore of sanctioned but un-utilised lines which are adequate to cover any short-term obligations in case the need arises. In ICRA's opinion, sizeable net-worth which provides cushion to absorb the possible future losses that may arise from business and company's ability to maintain prudent capitalisation going forward as well, will remain a key monitorable. ICRA expects 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 business and strategy-based/arbitrage (proprietary) trading with proprietary trading accounting for a sizeable proportion of the group's earnings. ICRA also notes the risks associated with the proprietary trading business though it can be liquidated whenever needed and the risk gets mitigated to some extent by group's diversified arbitrage strategies and the risk management systems for the mitigation of such risks such as scenario simulations, stress testing etc. In FY2021, proprietary trading income accounted for 79% of the Group's total income (63% in FY2020), while broking accounted for 15% (20% in FY2020) in FY2021, with balance coming from net interest income and other fee-based income. However, the track record of PSBSPL in consistently reporting trading profits since inception (over 26 years) amid adverse capital market conditions and operating with minimal debt from the promoters only with no external debt and negligible gearing which 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 (Rs.2,292 crore in 9M FY2022, Rs.1,229 crore in FY2021 and Rs.1,152 crore in FY2020), 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. However, PSBSPL broking income increased to Rs.55.2 crore in FY2021 from Rs. 30.6 crore in FY2020 and further to Rs.53.5 crore in 9MFY2022 which demonstrates the management's focus on retail broking. 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 focusing on rolling out an improved and upgraded retail platform along with increased focus on marketing initiatives to improve the brand visibility. Going forward, PSBSPL's ability to achieve meaningful diversification in its revenue stream would remain critical for 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 under this segment. For the HFT desk, the proportion of capital to be employed and the risk management measures adopted for the same will remain key monitorable. The proprietary trading business remains exposed to market risk and thus the variability of earnings remains high because of its high dependence on capital markets. However, the Group’s track record in this business and adequate net-worth to absorb any possible losses, however, provides comfort. Also, PSBSPL has reported profits from the trading operations despite periods of extreme volatility during the past 20 years. It reported proprietary trading income of Rs. 287.1 crore in FY2021 (YoY growth of 201%) and Rs. 252.2 crore in 9M FY2022. 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, 2021. The primary liquidity requirement is for placing margins at the exchanges and managing working capital requirements in proprietary trading business and fulfilling client margin requirements in the broking business. PSBSPL deployed an average margin of ~Rs. 748 crore at the exchanges (funded through own and client funds/securities) between April 2021 and December 2021, As on December 31, 2021, the company had Rs. 63 crore of un-encumbered cash and bank balances and Rs. 88 crore of liquid investments as against zero of fund-based borrowings. Further, it had short-term liquid trading book worth Rs. 160 crore, which can be liquidated if needed and Rs. 138 crore of sanctioned but un-utilised lines which are adequate to cover any short-term debt obligations if required.

Rating sensitivities

Positive factors – ICRA could upgrade the rating on the 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 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 rating methodology for broking entities
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 with a track record of over 26 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 stock broking 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. 149 crore on income of Rs. 340.1 crore in 9MFY2022 (provisional). In FY2021, the entities reported a combined net profit of Rs. 144 crore on total income of Rs. 363.9 crore against reported net profit of Rs. 32.2 crore on a total income of Rs. 150.9 crore in FY2020. The Group's net worth stood at Rs. 812.9 crore as on December 31, 2021 on a provisional basis.

Key financial indicators (audited) consolidated

PSBSPL and PCBPL	FY2019	FY2020	FY2021	9MFY2022*
	Audited	Audited	Audited	Provisional
Net Brokerage Income (Rs. crore)	30.2	28.4	54.1	52.8
Trading Income (Rs. crore)	114.4	95.4	287.1	252.5
Other Non-interest Income (Rs. crore)	1.2	0.5	0.7	0.6
Net Interest Income (Rs. crore)	21.0	24.3	20.8	33.4
Net Operating Income (NOI; Rs. crore)	63.7	55.5	76.8	87.6
Total Operating Expenses (Rs. crore)	132.4	119.5	178.9	146.9
Profit before Tax (Rs. crore)	48.8	38.8	193.2	198.9
Profit after Tax (PAT; Rs. crore)	42.4	32.2	144.2	148.6
Net Worth (Rs. crore)	470.4	488.5	655.7	812.9
Borrowings (Rs. crore)	16.5	47.3	7.9	34.9
Gearing (times)	0.03	0.10	0.01	0.04
Cost to Income Ratio (%) (incl. trading income)	74%	79%	49%	43%
Return on Net Worth (%)	18%	7%	25%	31%
PAT/NOI (%)	66%	58%	188%	192%

Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Mar 24, 2022	NA	NA	NA
1	Bank Facilities	Long Term	600.00	420.00	[ICRA]A (Stable)	-	-	-

Source: Company, ICRA Research

Complexity level of the rated instrument

Instrument	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: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Bank Facilities	NA	NA	NA	225	[ICRA]A (Stable)
NA	Bank Facilities	NA	NA	NA	95	[ICRA]A (Stable)
NA	Bank Facilities	NA	NA	NA	75	[ICRA]A (Stable)
NA	Bank Facilities	NA	NA	NA	25	[ICRA]A (Stable)
NA	Bank Facilities	NA	NA	NA	180	[ICRA]A (Stable)

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Annexure-2: List of entities considered for consolidated analysis

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

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Branches



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