

November 28, 2017

SBI DFHI Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Issuer Rating ¹	-	[ICRA]AAA (stable); Reaffirmed
Total	-	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the issuer rating of [ICRA]AAA (pronounced ICRA triple A) with stable outlook to SBI DFHI Limited (SBI DFHI)².

Rationale

The rating factors in the strength of SBI DFHI's parent – State Bank of India (SBI, rated [ICRA]AAA(stable)[ICRA]A1+), that holds 72.17% stake in the company – and the continued managerial, operational and financial support expected from SBI given the shared brand name and strategic importance of the company to the SBI Group for its primary dealer (PD) business. The rating also factors in the company's strong capitalisation, its adequate internal prudential liquidity norms and risk management systems covering the market risks inherent to a PD. The rating also takes into account the liquid nature of the company's investment portfolio, the low credit risk of its non-SLR investments, the significant improvement in its profitability during FY2017 and the large counter-party limits with other money market participants for call and repo borrowings, besides the Reserve Bank of India's (RBI) continued liquidity support to PDs.

ICRA however takes note of the low diversity in the company's revenues with limited fee income, and the vulnerability of its overall income and profitability to volatility in interest rate movements; however, the company's strong capitalisation provides comfort. The rating remains sensitive to the shareholding of SBI and its continued support to SBI DFHI.

Key rating drivers

Credit strengths

- **Strong parentage of SBI** – ICRA takes comfort from the strong parentage of SBI (72.17% stake as on March 31, 2017), the shared brand name and the resulting operational, managerial and financial support available to SBI DFHI from the SBI Group. In ICRA's view, SBI DFHI is strategically important to the SBI Group for its PD business and is likely to receive continued support. Nevertheless, the rating remains sensitive to SBI's shareholding in SBI DFHI and the support it provides currently to the entity.

¹ With effect from Sep 1, 2017, ICRA has aligned the symbols and the definitions of ratings pertaining to the Issuer Rating Scale with that of the Long-Term Rating Scale. The change in the symbol is not to be construed as a change in the credit rating. Please refer to ICRA's website for more details

² For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

- **Strong capitalisation profile** – The company’s capital adequacy ratio (CRAR) was strong at 90.57% as on March 31, 2017 (37.89% as on March 31, 2016) as against the RBI stipulation of a minimum 15%. Given the vulnerability of trading volumes and profitability to market volatility, a PD’s net worth assumes considerable significance from a credit perspective. SBI DFHI’s net worth of Rs. 1,046 crore as on March 31, 2017, imparts considerable comfort. ICRA takes note of the proposed buy back of shares of SBI DFHI worth Rs. 144 crore by SBI DFHI and believes that this is unlikely to affect the capitalisation profile of the company as it has excess capital as on date.
- **Adequate risk management systems** – The absence of adequate and effective hedging instruments in the fixed income securities market would continue to expose SBI DFHI’s (and other PDs) profitability to domestic interest rate volatility. Hence, SBI DFHI’s future performance will be critically dependent on its internal risk control systems and trading strategies. ICRA takes comfort from the company’s well defined internal trading limits and adequate risk management systems for the current scale of operations.
- **Sound liquidity profile and asset profile** – SBI DFHI’s liquidity profile is comfortable with funds parked in liquid instruments like government securities (G-Secs) and treasury bills (T-bills). The company’s assets and liability are both short term in nature, resulting in a matched asset liability mix and sound liquidity profile. ICRA takes comfort from SBI DFHI’s liquid portfolio and its large counter-party limits with other money market participants for call and repo borrowings, apart from the RBI’s liquidity support to PDs. SBI DFHI continues to fulfill its regulatory bidding commitments at the primary auctions and meets the minimum success and turnover ratio requirements for G-Secs and T-Bills. The company maintains about 60-70% of its total portfolio as SLR investments. Given the large share of portfolio in SLR investments, credit risk is low as reflected in the nil NPAs and zero credit losses in the past four years.
- **Improvement in profitability supported by trading gains** – With the decline in domestic interest rates, SBI DFHI earned sizable trading gains of Rs. 222 crore during FY2017 as compared with Rs. 65 crore during FY2016. Consequently, its net profit increased to Rs. 176 crore during FY2017 (return on average assets, ROA of 3.9% and return on net worth, RONW of 16.9%) as compared with a net profit of Rs. 72 crore during FY2016 (ROA of 1.5% and RONW of 7.2%).

Credit weaknesses

- **Low diversification of revenues** – SBI DFHI’s revenues largely consist of income from trading and interest income from its portfolio with fee income forming less than 1% of the total revenues during FY2017.
- **Vulnerability to interest rates** – Being a PD, SBI DFHI’s financial profile is exposed to risks arising from interest rate movements. As underwriting and trading of G-Secs forms a major portion of its business, rising interest rates affect the volume and income levels of SBI DFHI and other PDs and declining interest rates improve the volume and income levels. Consequently, the entity’s profitability will remain linked to interest rate movements.
- **Vulnerability to change in regulatory framework** - Apart from seeking an underwriting commitment and turnover for G-Secs, and a minimum bid success ratio of 40% for T-Bills, the regulatory framework favourably allows PDs to access the money markets and the LAF of the RBI. However, any adverse changes in the regulatory framework may have an adverse impact on the operations and credit profiles of PDs.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Rating Methodology for Primary Dealers](#)

About the company:

SBI DFHI Limited (SBI DFHI) is a subsidiary of State Bank of India (SBI, rated [ICRA]AAA/stable/[ICRA]A1+) which held a 72.17% stake in the company as on March 31, 2017 while the balance was held by other financial institutions and banks. SBI DFHI was created out of merger in 2004 of RBI promoted Discount & Finance House of India (DFHI) and SBI Gilts Limited (subsidiary of SBI). SBI DFHI is primarily engaged in underwriting and trading of G-Secs and T-Bills, and trading in corporate bonds. In March 2017, the company started providing advisory services also.

SBI DFHI is among the largest standalone primary dealers in the country in terms of net worth (Rs. 1,046.42 crore as on March 31, 2017). The company reported a net profit of Rs. 176.44 crore (ROA of 3.9% and ROE of 16.9%) on a total income of Rs. 602.55 crore during FY2017 as compared with a net profit of Rs. 72.19 crore (ROA of 1.5% and ROE of 7.2%) on a total income of Rs. 429.97 crore during FY2016.

Key Financial Indicators (Audited)

	FY2016	FY2017
Interest & discount income	361.49	378.20
Trading Income	64.81	222.31
Fee based and other income	3.67	2.05
Interest Expenses	291.79	298.98
Net Income	138.18	303.57
Operating Expenses	15.36	17.67
Profit before tax	108.86	269.20
Profit after tax (PAT)	72.19	176.44
Net worth	1,001.28	1,046.42
Borrowings	4,815.85	1,979.45
Stock in trade/Investments	5685.66	2992.34
Total Assets	5835.45	3187.19
PAT/Average total assets	1.5%	3.9%
PAT/ Net worth	7.2%	16.9%
Total Debt/ Net worth (times)	4.8	1.9

Note: Amount in Rs. crore

Source: SBI DFHI and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years	
		Type	Amount Rated (Rs. crore)	November 2017	FY2017	FY2016
					June 2016	April 2015
1	Issuer Rating	Long Term	-	[ICRA]AAA (stable)	IrAAA (stable)	IrAAA (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

ISIN No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating
NA	Issuer Rating	-	-	-	-	[ICRA]AAA (stable)

Source: SBI DFHI Limited

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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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