April 28, 2023

SBI DFHI Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Commercial Paper Programme	950	950	[ICRA]A1+; reaffirmed
Total	**950**	**950**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in the strength of SBI DFHI Limited's parent, State Bank of India {SBI; rated [ICRA]AAA (Stable)/[ICRA]AA+ (Stable)}, which holds a 69.04% stake (total 72.17% held by SBI Group) in the company. The ratings also consider 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 dealership business. The ratings reaffirmation also factors in SBI DFHI's adequate risk management policies and adherence to internal prudential norms, which mitigate the market risks. The ratings also consider the company's strong capitalisation and sound asset profile. Given its satisfactory net worth, the company has sufficient cushion to withstand the impact of adverse interest rate movements, resulting in a strong capitalisation profile.

The ratings are also supported by SBI DFHI's strong liquidity profile, as reflected in the high share of liquid Government securities (G-Secs) in the overall assets and access to call money and borrowings under repo from the market, apart from access to a standing liquidity facility (SLF) from the Reserve Bank of India (RBI) for participating in primary auctions. The share of non-statutory liquidity ratio (non-SLR) securities has remained higher than peers, but largely remains in highly rated corporate bonds and short-term money market instruments. The ratings factor in the importance of primary dealers (PDs) for the RBI for the market-making activity of G-Secs.

ICRA, however, notes the less-diversified revenue stream of the company and its high reliance on interest income and trading income with fee income largely comprising underwriting fee on G-Secs. Further, ICRA notes that SBI DFHI's earnings profile will remain susceptible to adverse interest rate movements as the portfolio largely comprises debt securities. Market rates and bond yields have been rising, given the inflationary pressure as well as the large sovereign borrowing programme.

Hence, going forward, SBI DFHI's ability to withstand the volatility in interest rates while adhering to its internal risk management policies, continued linkages with its parent, and the ability to withstand any regulatory changes for PDs will remain key rating sensitivities. Nevertheless, the company's strong capitalisation provides comfort. The ratings remain sensitive to SBI's shareholding and its continued support to SBI DFHI.

Key rating drivers and their description

Credit strengths

Strong parentage – ICRA takes comfort from the strong parentage in the form of SBI (69.04% stake as on December 31, 2022), the shared brand name and the resulting operational, managerial and financial support available to SBI DFHI from the SBI Group. Its board of directors consists of members who had previously served at SBI. The bank's liquidity support is reflected in the sanctioned bank lines of Rs. 2,655 crore, including an intraday facility that is available to the PD.

In ICRA's view, SBI DFHI is strategically important to the SBI Group for its PD business and is likely to continue receiving support. Nevertheless, the ratings remain sensitive to SBI's shareholding in SBI DFHI and the support it provides to the company.

Strong capitalisation profile – The company's capital adequacy ratio (CRAR) was strong at 30.96% as on December 31, 2022 against the RBI stipulation of a minimum of 15%. The CRAR had decreased from 42.39% as of March 31, 2022 due to the losses incurred in 9M FY2023 and a dividend payout of Rs. 85 crore pertaining to FY2022.

As it is a PD, the underwriting and trading of G-Secs constitute the company's core activity. Therefore, its profitability and capital profile are susceptible to market risks arising out of interest rate movements. 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. 1,351 crore, as on December 31, 2022, provides considerable comfort. The company's NOF was of Rs. 1,211 Crore as on December 31,2022. The price value of a basis point (PVBP) stood at Rs. 1.67 crore, indicating adequate ability to absorb large adverse movements in interest rates while maintaining the CRAR above the regulatory requirement. As the interest rates went up sharply in FY2023 and the interest spread on investments held earlier declined, the company increased the size of its portfolio of debt securities to invest in fresh securities at higher rates. This resulted in a higher leverage[1] of 12.49 times in December 2022 vis-à-vis 6.76 times as of December 31, 2021.

Sound asset profile – SBI DFHI maintains about 75-80% of its total investment portfolio in the form of SLR investments (non-SLR portfolio stood at Rs. 3,605 crore in December 2022). Credit risk largely emanates from the non-SLR portfolio and the company had only one non-performing advances (NPA) account of Rs. 45.99 crore as of March 31, 2021, which was partly recovered in FY2022 while the balance was written off. Apart from this, there were no credit losses in the past five years. The net NPA remained nil as on December 31, 2022 with no vulnerable investments in the non-SLR portfolio.

Strong liquidity profile – SBI DFHI's non-SLR or corporate debt investment portfolio has also remained well diversified across highly rated corporates. About 47% of the non-SLR book was in short-term money market instruments while 46% of the non-SLR book was in AAA/AA+ rated corporates as of December 31, 2022. Corporate debt investments can be easily funded through call/notice money {subject to daily average of 50% of net owned funds (NOF)}, commercial paper, inter-corporate deposits (150% of NOF) or bank lines. These investments can also be sold off to generate liquidity if required. With funds parked in highly liquid investments, SBI DFHI's overall liquidity remains strong.

SBI DFHI's liquidity is also supported by its access to the money market for call and repo borrowings, in addition to the RBI's liquidity adjustment facility (LAF). Additionally, the company has sanctioned bank limits of Rs. 2,655 crore from SBI (including intraday facility of Rs. 1,100 crore and overnight/term facility of Rs.1,455 Crore) and a Rs. 400-crore intraday line from ICICI Bank. Though SBI DFHI's liabilities are largely short term in nature compared to the long tenure of the assets, the liquid nature of the assets mitigates the asset-liability risk. SBI DFHI continues to fulfil its regulatory bidding commitments at the primary auctions with minimum success and turnover ratio requirements for dated G-Secs and Treasury Bills (T-Bills).

Adequate internal prudential norms and risk management systems – Prudent risk management policies and adherence to the same are critical for a PD, given their susceptibility to market risk related to debt securities and credit risk on account of non-SLR securities. ICRA takes comfort from the adequate risk management policies approved by the company's Risk Management Committee, comprising members from the board, with well-defined limits for various exposures and loss mitigation measures. The Committee also monitors and ensures adherence to these policies on a daily basis. As per the risk management policy, investment in non-SLR securities is allowed only for investment with a minimum rating of AA for private sector and A for public sector undertakings, which mitigates any credit risk. However, in practice, the company does not invest in securities below AAA/AA rating. AAA rated entities accounted for ~88% of the total non-SLR portfolio by value as on December 31, 2022. This limits the credit or liquidity risk in this portfolio.

[1] *Leverage = Debt/NOF*

Credit challenges

Low diversification of revenues – SBI DFHI's revenue stream is relatively less diversified compared to other PDs, with interest income and trading income accounting for almost 99% of its total revenue in 9M FY2023. In FY2022, the company reported higher underwriting and other income of Rs. 12 crore vis-à-vis Rs. 13 crore in FY2021 due to higher devolvement in FY2022. This was recorded at Rs. 4 crore in 9M FY2023 due to lesser devolvement of G-sec in FY2023. SBI DFHI incurred mark-to-market (MTM) losses of Rs. 100 crore in 9M FY2023 and Rs. 106 crore in FY2022. With Government borrowings for FY2024 expected to be elevated, underwriting and other income could remain high though this will be subject to the volume of devolvement in the year. Nonetheless, its share in the total revenue would remain low. Going forward, a pause in the monetary policy rate hikes could ease the volatility in interest rates and short-term funding rates, driving a steady increase in net interest income and supporting efforts to limit trading losses.

Earnings vulnerable to interest rate movements – As the company's portfolio comprises debt securities, its earnings profile remains susceptible to adverse movements in the interest rates. As short-term interest rates began to rise sharply in FY2023, the net interest margin narrowed to 1.2% in 9M FY2023 from 2.54% in FY2022 and 3.28% in FY2021 due to the higher cost of funds. Over and above this, SBI DFHI incurred MTM and trading losses of Rs. 121 crore in 9M FY2023, leading to a net loss of Rs. 17 crore. Going forward, the relative easing of volatility in interest rate movements and a pause in rate hikes could help the overall profitability compared to the FY2023 levels.

Vulnerability to changes in regulatory framework – The RBI is the regulatory authority for PDs and has prescribed operational guidelines for underwriting commitments for G-Secs, bidding commitments, the success ratio for T-Bills, the achievement of minimum turnover ratios and funding support in the form of LAF/SLF. Therefore, a significant change in the regulatory framework for PDs, which adversely impacts the company's operational and financial profile, can affect its funding cost and profitability.

Liquidity position: Strong

The ratings are supported by the company's strong liquidity profile, given the inherent nature of the PD business. This is demonstrated by the high share of G-Secs in the investment portfolio (77% of total investments on a daily average basis for Q3 FY2023). Furthermore, SBI DFHI's non-SLR book (23% of investments on a daily average basis for Q3 FY2023) largely comprises highly liquid corporate debt securities and remained comfortable vis-à-vis its NOF, thereby minimising any liquidity risk in the corporate bond portfolio. SBI DFHI also has access to call money/LAF and SLF funding from the RBI. Moreover, ICRA notes that the company has intraday liquidity facilities from SBI and ICICI Bank, which can be used to meet its intraday liquidity requirements. Further, ICRA expects support from the parent to be forthcoming, if required, to support the company's liquidity profile.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The ratings can be revised if there is a material change in SBI's ratings or a significant change in the shareholding or linkages with the parent and/or if SBI DFHI has sustained losses, which result in considerable erosion of the net worth. Moreover, any regulatory change adversely impacting the PD business will remain a key negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Primary Dealers Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group support	ICRA expects SBI to provide financial, managerial and operational support when required, given the shared brand name and SBI's ownership stake of 69.04% (total 72.17% held by SBI Group)
Consolidation/Standalone	Standalone

About the company

SBI DFHI is a State Bank of India Group Company, created from the merger of the RBI-promoted Discount & Finance House of India (DFHI) and SBI Gilts Limited (subsidiary of SBI) in 2004. SBI DFHI was incorporated under the provisions of the Companies Act, 1956 (as amended by the Companies Act, 2013) on March 8, 1988. It is registered as a non-banking financial company (NBFC) and is a standalone PD created to support the book building process for the primary auction of G-Secs. As it is a PD, the company's core activities comprise underwriting, bidding, market making and trading in fixed income securities (T-Bills, G-Secs, state development loans, corporate bonds). SBI DFHI actively participates in money market instruments (certificates of deposit, commercial paper, inter-corporate deposits, call & notice/term money deposits). It is very active in the retailing of G-Secs, including small lots.

SBI DFHI is one of the largest standalone PDs in the country in terms of net worth (Rs. 1,351 crore as on December 31, 2022). It reported a net loss of Rs. 17 crore {RoA of (0.16%) and return on equity (RoE) of (1.65%)} on total income of Rs. 645.21 crore in 9M FY2023 compared to a net profit of Rs. 121 crore (RoA of 1.50% and RoE of 11.38%) on total income of Rs. 506.28 crore in 9M FY2022.

Key financial indicators (audited)

SBI DFHI Limited	FY2021	FY2022	9M FY2023*
Net interest income	351	293	129
Trading profit (including MTM gain/loss)	22	(75)	(121)
Income from services, dividend & other income	15	12	4
Operating costs	42	42	31
PBT	346	191	(19)
PAT	252	124	(17)
Net worth	1,402	1,452	1,351^
Borrowings	8,557	11,367	15,128
Stock-in-trade	9,742	12,573	15,968
Total assets	10,014	13,079	16,658
PAT/ATA	2.35%	1.23%	(0.16%)
PAT/Net worth (RoNW)	17.95%	9.78%	(1.65%)
Leverage ratio (daily average; times)	9.85	8.20	11.41

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. Crore;*

^ Including Other comprehensive Income (OCI) of Rs.140 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
					Apr 28, 2023	Apr 29, 2022	Apr 12, 2021	Mar 16, 2020
1	Issuer Rating	Long Term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Commercial Paper Programme	Short Term	950	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Rating	Not Applicable
Commercial Paper Programme	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
NA	**Issuer Rating**	NA	NA	NA	-	[ICRA]AAA (Stable)
Not Placed	**Commercial Paper Programme**	NA	NA	NA	950	[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis : Not Applicable

ANALYST CONTACTS

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

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Gayatri Kulkarni
+91 22 6114 3471
gayatri.kulkarni@icraindia.com

Aashay Choksey
+91 22 6114 3430
aashay.choksey@icraindia.com

Vaibhav Arora
+91 124 4545 386
vaibhav.arora@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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

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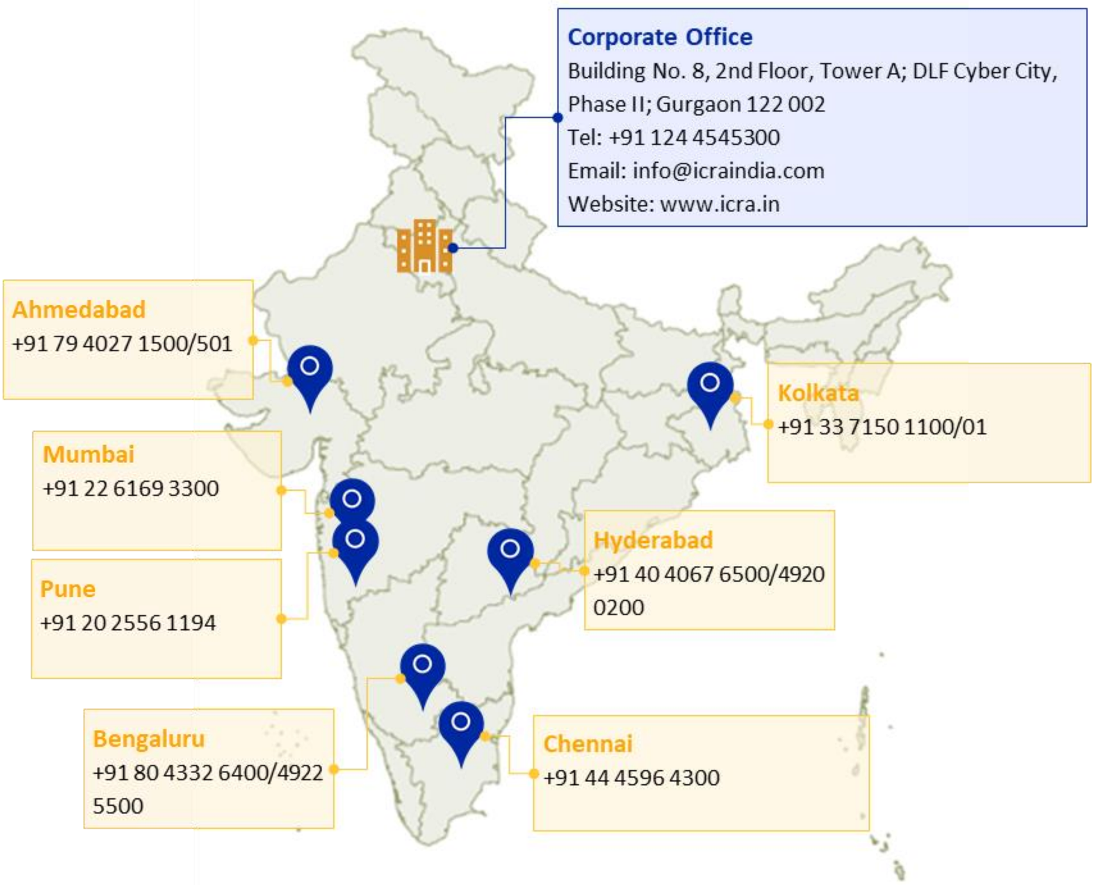

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