State Bank of Hyderabad

March 24, 2017

Ratings

Instruments	Amount Rated (Rs. Crore)	Rating[1]	Rating Action
Proposed Basel III Compliant Additional Tier I Perpetual Bonds @	200	**CARE AA+; Stable [Double A Plus; Outlook: Stable]**	Assigned
Total	**200 (Rupees Two Hundred crore only)**		

Details of instruments/facilities in Annexure-1

@CARE has rated the aforesaid Basel III Compliant Tier I Perpetual Bonds after taking into consideration its key features as below:

- The bank has full discretion at all times to cancel coupon payments.
- The coupon is to be paid out of current year profits. However, if the current year's profits are not sufficient, coupon payment may be paid subject to availability of sufficient revenue reserves and/or credit balance in profit and loss account provided the bank meets the minimum regulatory requirements for Common Equity Tier I [CET I], Tier I and Total Capital Ratios at all times and subject to the requirements of capital buffer frameworks as prescribed by the Reserve Bank of India [RBI].

The instrument may be written-down upon CET I breaching the pre-specified trigger of 5.5% before March 31, 2019, and 6.125% on and after March 31, 2019, or written-off / converted into common equity shares on occurrence of trigger event called point of non-viability (PONV). The PONV trigger shall be determined by RBI. Any delay in payment of interest/principal (as the case may be) due to invocation of any of the features mentioned above would constitute as an event of default as per CARE's definition of default and as such these instruments may exhibit a somewhat sharper migration of the rating compared with the conventional subordinated debt instruments.

Detailed Rationale & Key Rating Drivers

The rating assigned to the Proposed Basel III Compliant Tier I Perpetual Bond issue of State Bank of Hyderabad (SBH) factors in capital support and 100% ownership of State Bank of Hyderabad (SBH) by the State Bank of India (SBI), (rated CARE AAA; Stable) comfortable capitalization level and moderate growth in deposits and advances and proposed merger with State Bank of India. The rating also factors in deterioration in asset quality as indicated by rise in gross non-performing assets (GNPA), net non-performing assets (NNPA) during FY16 (refers to the period April 1 to March 31) and its resultant adverse impact on the profitability of the bank.

The ability to improve asset quality, spreads and profitability coupled with the ability to sustain growth in business, and diversify geographically are the key rating sensitivities.

CARE takes note of proposed merger of the five SBI associate banks, State Bank of Hyderabad (SBH), State Bank of Bikaner & Jaipur (SBBJ), State Bank of Mysore (SBM), State Bank of Travancore (SBT) and State Bank of Patiala (SBP) with its parent SBI which is expected to be completed in near term.

Detailed description of the key rating drivers

Key Rating Strengths

Strong Parentage & operational Synergies with parent: State Bank of Hyderabad is 100% subsidiary of State Bank of India. SBI is the largest bank in India having an asset base of Rs.22.59 trillion as on March 31, 2016. The State Bank Group has a network of over 20,000 branches including branches of its five associate banks spread across the country. SBH also benefits from the operational and managerial synergies arising from its association with SBI, especially in key areas such as risk management, credit, treasury etc.

Adequate Capitalization Levels: As on March 31, 2016, the banks total CAR under Basel III stood at 11.62% with Tier I CAR at 9.27% as compared to total CAR at 11.26% and Tier I CAR at 9.18% as on March 31, 2015. CAR has improved marginally

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications*

and the same continues to be comfortable and well above the requirements as per Basel III guidelines of 9.625% for total CAR, 7.625% for tier-I capital. The banks total CAR under Basel III stood at 10.78% as on December 31, 2016.

Growth in income and moderate growth in advances and deposits: Total income in FY16 increased by 3.19% to Rs.15,632.78 crore (from Rs.15,148.82 crore in FY15) backed by 2.63% growth in interest income and 9.10% growth in non-interest income. The bank registered a growth of 5.72% and 5.38% in net advances and deposits, respectively in FY16. On the deposits side, the proportion of low-cost CASA deposit base has further improved by 237 bps to 35.59% as on March 31, 2016 mainly due to strong growth in savings bank deposits. Demand deposits (current account deposits) grew marginally by 3% during the same period.

Key Rating Weaknesses

Deterioration in profitability and spreads: Net Interest Margin has deteriorated marginally by 9 bps to 2.88% in FY16 (PY: 2.97%) due to increase in interest expenses by 1.72%. Yield on advances reduced from 10.92% in FY15 to 10.27% in FY16, net spread declined to 1.06% in FY16 from 1.30% in FY15 and core spread declined to 3.50% in FY16 from 3.84% in FY15. PAT reduced by 19.15% to Rs.1,064.93 crore (PY: Rs.1317.14 crore) due rise in provisioning for NPAs during FY16 which increased to Rs.1,583.28 crore in FY16 (PY: Rs.668.88 crore).

Deterioration in asset quality; stressed assets continue to be high: The asset quality of the Bank deteriorated during FY16 with Gross and Net NPA increasing to 5.81% and 3.37% as on March 31, 2016 in comparison to 4.59% and 2.24% respectively as on March 31, 2015. The reported provision coverage ratio of the bank stood at 56.96% as on March 31, 2016 as compared to 61% as on March 31, 2015. The standard restructured assets outstanding were Rs.7006.21 crore (Rs.7,179.58 crore as on March 31, 2015) comprising 6.31% of net advances (PY: 6.83%) and 67.37% of net worth as on March 31, 2016 (PY: 74.81%). In 9MFY17, asset quality has deteriorated significantly with Gross NPA being at 14.74% (PY: 5.28%) and Net NPA at 9.08% (PY: 2.71%).

Analytical approach:
Standalone

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
CARE's Rating Methodology For Banks
Rating framework for Basel III instruments (Tier I & Tier II)
Financial Sector Ratios

About the Company
State Bank of Hyderabad (SBH) was incorporated on August 8, 1941, under the Hyderabad State Bank Act, 1941. SBH became a subsidiary of the State Bank of India on October 1, 1959 and is now the largest associate bank (based on the number of branches and volume of business) of the State Bank of India. SBH is a wholly-owned subsidiary of the State Bank of India (SBI). SBH had 1,933 branches as of March 31, 2016, with nearly 63% of the branches in the states of Andhra Pradesh and Telangana. The bank is operating entirely on Core Banking Platform since 2005.
In FY16, the bank registered a growth of 5.72% and 5.38% in net advances and deposits, respectively. The growth in the advances was witnessed in nearly all the segments with Agriculture at 23% YoY, Personal loans at 14% YoY and Services at 11% YoY. Priority sector lending constituted 40.27% of Adjusted Net Bank Credit of Bank vis-à-vis the benchmark of 40%. On the deposits side, the proportion of low-cost CASA deposit base has further improved by 237 bps to 35.59% as on March 31, 2016 mainly due to strong growth in savings bank deposits, which grew by 17% y-o-y in FY16. Demand deposits (current account deposits) grew marginally by 3% during the same period. The above figure shows the bank's segment wise break-up of outstanding gross loan book. Provision Coverage stood at 56.96% as on March 31, 2016. The Bank reported a Capital Adequacy Ratio of 11.62% (Tier I – 9.27%) as on March 31, 2016 under Basel III guidelines.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds	-	-	-	200.00	CARE AA+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015	Date(s) & Rating(s) assigned in 2013-2014
1.	Bonds-Perpetual Bonds	LT	350.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
2.	Bonds-Lower Tier II	LT	-	-	1)Withdrawn (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
3.	Bonds-Upper Tier II	LT	500.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)

					2)CARE AAA (10-Oct-16)			
4.	Bonds-Lower Tier II	LT	160.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
5.	Bonds-Upper Tier II	LT	325.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
6.	Bonds-Upper Tier II	LT	925.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
7.	Bonds-Perpetual Bonds	LT	135.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
8.	Bonds-Perpetual Bonds	LT	200.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (09-Oct-15)	1)CARE AAA (08-Jul-14)	1)CARE AAA (03-Oct-13)
9.	Bonds-Tier II Bonds	LT	500.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	1)CARE AAA (30-Dec-15)	-	-
10.	Bonds-Tier II Bonds	LT	200.00	CARE AAA; Stable	1)CARE AAA; Stable (14-Dec-16) 2)CARE AAA (10-Oct-16)	-	-	-
11.	Bonds	LT	200.00	CARE AA+; Stable	-	-	-	-

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