November 17, 2021

Bank of Baroda: Ratings reaffirmed; [ICRA]AA+ (Stable) assigned to AT-I bonds

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant AT-I Bonds	-	3,000.00	[ICRA]AA+ (Stable); assigned
Basel III Compliant AT-I Bonds	325.00	325.00	[ICRA]AA+ (Stable); reaffirmed
Basel III Compliant Tier II Bonds	2,450.00	2,450.00	[ICRA]AAA (Stable); reaffirmed
Fixed Deposit Programme	-	-	MAAA (Stable); reaffirmed
Total	**2,775.00**	**5,775.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation continues to factor in Bank of Baroda's (BoB) sovereign ownership and its strong franchise, imparting a healthy and stable deposit base and a superior liquidity profile. It is the fourth largest public sector bank (PSB) and the sixth largest bank in the Indian financial system in terms of total business (advances and deposits) as on June 30, 2021. Given its importance, ICRA expects the bank to continue to receive support from the Government of India (GoI), if required.

BoB's gross slippage rate remains elevated because of the Covid-19-induced stress on the asset quality. However, this has been offset by the relatively better recoveries and upgrades, given the relatively granular slippages compared to the past and other recoveries from the stressed accounts. As a result, the credit provisions have moderated in relation to the core operating profits, leading to improved internal capital generation for the bank. The total standard restructuring (including micro, small and medium enterprise (MSME) and Covid-19 restructuring) implemented by the bank stood at 3.0% of standard advances as on September 30, 2021. While the impact of the second wave of Covid-19 on the asset quality is expected to decline, the asset quality will remain monitorable for the overdue loan accounts and the standard restructured book.

The net non-performing advances (NNPAs) have remained at steady levels since the onset of the Covid-19 pandemic in March 2020 at 2.8-3.1%. This continues to provide comfort for future profitability, even though the profitability is expected to remain modest (annualised return on assets (RoA) of 0.57% in H1 FY2022). With the improved capital accretion, ICRA expects BoB to remain self-sufficient for its capital requirements for absorbing incremental stress as well as for growth requirements while maintaining more than the desired cushion of more than 1% on the capital above the regulatory levels (including capital conservation buffers; CCBs). This will drive the Stable outlook on the ratings.

The rating for the Additional Tier – I (AT-I) bonds factors in the healthy level of distributable reserves (DRs) [1], which can be used to service the coupon on these bonds in a year of loss. As of September 30, 2021, the DRs were estimated at 6.7% of the risk-weighted assets (RWAs) after factoring in the setoff of its accumulated losses against the share premium account, for which BoB has received regulatory approval from the Reserve Bank of India (RBI). ICRA notes that many public sector banks (PSBs) have made similar adjustments recently and have already received regulatory approval for the same. Apart from the healthy level of the DRs, the outlook on the profitability and capital position also supports the rating on these bonds.

[1] *Calculated as per the amendment in Basel III capital regulations for AT-I bonds by the RBI, vide its circular dated February 2, 2017. As per the amended definition, DRs include all reserves created through appropriation from the profit and loss account*

Key rating drivers and their description

Credit strengths

Sovereign ownership; fourth largest PSB and sixth largest bank in Indian banking system in terms of total business – The GoI remains the largest shareholder of BoB with a 63.97% equity stake as on March 31, 2021. It has infused capital of Rs. 21,739 crore between FY2018 and FY2020 into the bank [including erstwhile Dena Bank (e-DB) and erstwhile Vijaya Bank (e-VB)]. BoB is the fourth largest PSB in the Indian banking sector as on June 30, 2021 in terms of total business and had a market share of 6.6% in the advances and 6.4% in the total deposits as on June 30, 2021.

Given its increased significance in the industry, ICRA expects that BoB could be classified as a domestic systemically important bank (D-SIB), which could require additional equity capital over and above the minimum regulatory requirements. This shall not be a challenge for the bank, given ICRA's outlook on the capital position. Further, ICRA expects BoB to receive continued support from the GoI in terms of required capital as and when required, given its significant importance in the system.

Improved capital position – In FY2021, the bank raised equity of Rs. 4,500 crore from the market, which led to a reduction in the GoI's stake to 63.97% as on March 31, 2021 from 71.60% earlier. With the capital raise and improved internal capital generation, BoB improved its capital ratios with CET I of 11.39% and Tier I of 13.21% as on September 30, 2021. ICRA estimates the bank is well placed in terms of its capital position for absorbing incremental stress as well as for growth requirements while maintaining more than the desired cushion of more than 1% on the capital above the regulatory levels.

With the improved capital position, the solvency[2] level also improved to 29% as on September 30, 2021 from 39% as on March 31, 2020 and ICRA expects the same to improve marginally in FY2022 even without any incremental capital raise. The subsidiaries largely remain self-sufficient in meeting their capital requirements in the near-to-medium-term and will require limited capital support from BoB.

Well-developed deposit franchise, leading to competitive cost of funds – Supported by its large branch network across India and well-developed customer franchise coupled with its widespread deposit franchise, the domestic current account and savings account (CASA) deposit base remained close to the PSB average. As it is the fourth largest PSB with a healthy corporate loan book, BoB's CASA share remains strong with a CASA ratio of 41.70% of total deposits as on September 30, 2021 (41.03% as on June 30, 2021). BoB operates with a low cost of interest-bearing funds, which stood at 3.5% in H1 FY2022 (partially supported by the sizeable overseas asset and deposit base). Going forward, ICRA expects BoB's liability profile to remain a significant positive for supporting its credit growth while maintaining superior liquidity and profitability.

Credit challenges

Asset quality remains monitorable – Fresh slippages remained elevated in H1 FY2022 (3.5% annualised), driven by the second wave of Covid-19 in Q1 FY2022 and a few large-ticket wholesale exposures. Despite higher slippages, the relatively granular nature of the slippages compared to the past has led to better recoveries. This, coupled with recoveries from legacy stressed assets, has kept the NNPAs at relatively stable levels compared to the pre-Covid level. The NNPAs remained steady at Rs. 19,602 crore (2.83%) as on September 30, 2021 compared to Rs. 21,577 crore (3.13%) as on March 31, 2020, while the credit costs remained under control at 1.5% (annualised) of advances in H1 FY2022 compared to 2.14% and 2.85%, respectively, in FY2021 and FY2020.

As a part of relief measures to borrowers impacted by Covid-19, the bank has restructured loans with a moratorium of up to two years to its borrowers. It had a standard restructured book of 3.0% of standard advances as on September 30, 2021. In addition, the special mention account (SMA)-1 and SMA-2 loan book (excluding below Rs. 5-crore ticket size) stood at 1.9% of standard advances as on September 30, 2021 (3.87% as on March 31, 2021). While ICRA expects that the slippages should incrementally tend to be lower than what BoB witnessed during the last few years, leading to a steady reduction in its credit

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[2] Solvency defined as (Net NPAs + Net security receipts + Net non-performing investments) / Core capital)

costs, the GNPAs and NNPAs, the asset quality will remain a monitorable for the overdue loan accounts and the standard restructured book.

Profitability to remain modest – Supported by the competitive cost of interest-bearing funds, improving asset quality and lower total slippages (lower interest reversals), the core operating profit (before divestments and trading income) improved to 1.59% of average total assets (ATA) in H1 FY2022 (1.46% in H1 FY2021). However, it remains below the pre-merger level of 1.67% in FY2019. This, coupled with the strong gains on the bond portfolios, resulted in an improvement in the pre-tax profit to 0.78% of ATA in H1 FY2022 (0.22% in H1 FY2021). As the bank moved to a new tax regime with lower tax rates, it wrote off deferred tax assets in FY2021, leading to a lower improvement in the RoA and return on equity (RoE).

Going forward, ICRA expects that BoB would largely be able to absorb the incremental credit provisions through its operating profits while reducing its NNPAs. However, the internal capital generation is likely to remain modest in FY2022 with an improvement expected from FY2023.

Liquidity position: Superior

BoB's liquidity profile remains superior supported by a high statutory liquidity ratio (SLR) of 24.8% of the net demand and time liabilities (NDTL) as on September 30, 2021 (above the regulatory requirement of 18%). ICRA expects BoB to maintain superior liquidity, given the large proportion of retail deposits and the high portfolio of liquid investments. It can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive factors – Not applicable as all the ratings are at the highest possible level

Negative factors – Given its sovereign ownership and its position as the fourth largest PSB, ICRA expects BoB to receive the requisite capital support from the GoI, if required. Any dilution in the expected stance will be a credit negative. Solvency weaker than 40% on a sustained basis could also be a credit negative for the bank.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The ratings factor in BoB's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support BoB with capital infusions, if required.
Consolidation/Standalone	The ratings are based on the standalone financial statements of BoB. However, in line with ICRA's limited consolidation approach, the capital requirements of BoB's key subsidiaries have been factored in while assessing its credit profile.

About the company

Bank of Baroda was incorporated in 1908 and nationalised in 1969, along with 13 other major commercial banks of India, by the GoI. BoB is headquartered in Vadodara while its corporate office is in Mumbai.

On September 17, 2018, the GoI announced the merger of Vijaya Bank and Dena Bank with BoB. The merger came into effect on April 01, 2019. As of March 31, 2021, the bank had 8,214 branches and 10,033 ATMs across India, of which ~60% are rural/semi-urban branches. It has an international presence spanning 96 overseas offices across 19 countries. Post-merger, BoB is the fourth largest PSB in the Indian banking sector in terms of total business (advances and deposits cumulatively as on June 30, 2021). The GoI held a 63.97% stake in the bank as on September 30, 2021.

BoB reported a net profit of Rs. 3,296 crore in H1 FY2022 on a total asset book of Rs. 11.71 lakh crore[3]. Its GNPA% and NNPA% stood at 8.11% and 2.83%, respectively, as on September 30, 2021. The regulatory capital adequacy ratio stood at 15.55% as on September 30, 2021 (CET I: 11.39% and Tier I of 13.21%).

Key financial indicators (standalone)

	FY2020	FY2021	H1 FY2021	H1 FY2022
Net interest income	27,451	28,809	14,323	15,458
Profit before tax	(1,802)	(5,556)	1,242	4,511
Profit after tax	546	829	814	3,296
Net advances (Rs. lakh crore)	6.90	7.06	6.70	6.94
Total assets* (Rs. lakh crore)	11.52	11.50	11.37	11.71
% Net interest margin / Average total assets	2.46%	2.50%	2.50%	2.66%
% Return on assets	0.05%	0.07%	0.14%	0.57%
% Return on net worth	0.83%	1.15%	2.46%	8.97%
% CET I	9.44%	10.94%	9.21%	11.39%
% Tier I	10.71%	12.67%	10.75%	13.21%
% CRAR	13.30%	14.99%	13.26%	15.55%
% Gross NPA	9.40%	8.87%	9.14%	8.11%
% Net NPA	3.13%	3.09%	2.51%	2.83%
% PCR (excl TWO)	69%	67%	74%	67%
% Solvency	39.0%	33.4%	30.1%	29.1%

Source: *BoB & ICRA Research; Amount in Rs. crore unless mentioned otherwise*
** Excluding revaluation reserve; All ratios as per ICRA calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

[3] *Excluding revaluation reserves*

Rating history for past three years

Sr. No.	Name of Instrument	Current Rating (FY2022)					Chronology of Rating History for the Past 3 Years				
		Type	Rated Amount (Rs. crore)	Amount Outstanding (Rs. crore)	FY2022		FY2021	FY2020	FY2019		
					Nov-17-2021	Jun-30-2021	Jun-12-2020	Apr-26-2019	Nov-29-2018	Sep-28-2018	Jun-11-2018
1	Basel III - Tier II Bonds Programme	Long Term	1,000.0	1,000.0	[ICRA]AAA (Stable)	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA (hyb)&	[ICRA]AAA (hyb)&	[ICRA]AAA (hyb) (Stable)
2	Term Deposits Programme	Medium Term	NA	NA	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA&	MAAA&	MAAA (Stable)
3	Basel III - Tier II Bonds Programme (erstwhile Vijaya Bank)	Long Term	1,450.0	1,450.0	[ICRA]AAA (Stable)	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA(hyb) (Stable)	-		-
4	Basel III AT-I Bonds (erstwhile Vijaya Bank)	Long Term	325.0	325.0	[ICRA]AA+ (Stable)	[ICRA]AA+(hyb) (Stable) Upgraded	[ICRA]AA(hyb) (Stable)	[ICRA]AA(hyb) (Stable)	-		-
5	Basel III AT-I Bonds	Long Term	3,000.0	Yet to be placed	[ICRA]AA+ (Stable)	-	-	-	-	-	-

***Source:** ICRA Research*

Removal of (hyb) suffix from Basel III instruments

In compliance with the circular issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021 for standardising the rating scales used by credit rating agencies, ICRA has discontinued its practice of affixing the (hyb) suffix alongside the rating symbols for hybrid instruments.

Accordingly, ICRA has removed the (hyb) suffix that was earlier being placed alongside the rating symbol for the hybrid instruments issued by BoB. The earlier and revised denotation of the rating for various instruments can be seen in the table above. This rating action only involves the removal of the (hyb) suffix and should not be construed as a change in the credit rating.

Complexity level of the rated instrument

Instrument	Complexity Indicator
Basel III Compliant Tier II Bonds	Highly Complex
Basel III Compliant AT-I Bonds	Highly Complex
Medium Term Fixed Deposit	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 instruments 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	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE705A08037	Tier II Bonds – Basel III	Oct-30-2014	9.15%	Oct-30-2024	500.00	[ICRA]AAA (Stable)
INE705A08052	Tier II Bonds – Basel III	Feb-18-2015	8.62%	Feb-18-2025	500.00	
INE705A08078	Tier II Bonds – Basel III	Jan-22-2016	8.64%	Jan-22-2026	450.00	
INE028A08059	Tier II Bonds – Basel III	Dec-17-2013	9.73%	Dec-17-2023	1,000.00	
INE705A08094	AT-I Bonds – Basel III	Jan-17-2017	10.49%	Jan-17-2022*	325.00	[ICRA]AA+ (Stable)
Yet to be issued	AT-I Bonds – Basel III	-	-	-	3,000.00	[ICRA]AA+ (Stable)
NA	Medium-term Deposits	-	-	-	-	MAAA (Stable)

 # As on November 10, 2021
** Call option date*
***Source:** BoB*

Key features of the rated instruments

The servicing of the Basel III Tier II bonds is not subject to any capital ratios and profitability. However, the Basel III Tier II Bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

The rated Basel III Compliant Tier I Bonds (AT-I bonds) have the following loss-absorption features that make them riskier:

- Coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel coupon payments. Cancellation of discretionary payments shall not be an event of default.
- Coupons can be paid out of the current year's profits. However, if the current year's profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made through the reserves and surpluses created through the appropriation of profits (including statutory reserves). However, the coupon payment is subject to the bank meeting the minimum regulatory requirements for CET I, Tier I and total capital ratios (including CCB) at all times as prescribed by the RBI under the Basel III regulations.

These Tier I bonds are expected to absorb losses through the write-down mechanism at the objective prespecified trigger point fixed at the bank's CET I ratio as prescribed by the RBI, i.e. 6.125% of the total RWAs (w.e.f. October 1, 2021) of the bank, or when the PONV trigger is breached in the RBI's opinion.

Given the above distinguishing features of the AT-I bonds, ICRA has assigned a one notch lower rating on these than the rating on the Tier II instruments. The DRs that can be used for servicing the coupon in a situation of inadequate profit or a loss during the year stood at a comfortable 6.7% of RWAs as on September 30, 2021. The rating on the Tier I bonds continues to be supported by the bank's capital profile (CET I: 11.39%, Tier I: 13.21% and CRAR: 15.55% as on September 30, 2021), which is likely to remain comfortable, given the outlook on BoB's profitability and its healthy capital-raising ability.

Annexure-2: List of entities considered for consolidated analysis

S. No.	Name of the entity	Ownership	Consolidation Approach
1	BOB Financial Solutions Limited	100.00%	Limited Consolidation
2	BOB Capital Markets Limited	100.00%	Limited Consolidation
3	Baroda Global Shared Services Limited	100.00%	Limited Consolidation
4	Baroda Sun Technologies Limited	100.00%	Limited Consolidation
5	Baroda Asset Management India Limited	100.00%	Limited Consolidation
6	Baroda Trustee India Private Limited	100.00%	Limited Consolidation
7	Bank of Baroda (Botswana) Limited	100.00%	Limited Consolidation
8	Bank of Baroda (Guyana) Limited	100.00%	Limited Consolidation
9	Bank of Baroda (New Zealand) Limited	100.00%	Limited Consolidation
10	Bank of Baroda (Tanzania) Limited	100.00%	Limited Consolidation
11	Bank of Baroda (UK) Limited	100.00%	Limited Consolidation
12	Nainital Bank	98.57%	Limited Consolidation
13	Bank of Baroda (Kenya) Limited	86.70%	Limited Consolidation
14	Bank of Baroda (Uganda) Limited	80.00%	Limited Consolidation
15	India First Life Insurance Company Limited	44.00%	Limited Consolidation
16	India Infradebt Limited	40.99%	Limited Consolidation
17	India International Bank (Malaysia), Berhad	40.00%	Limited Consolidation
18	Baroda Uttar Pradesh Gramin Bank	35.00%	Limited Consolidation
19	Baroda Rajasthan Gramin Bank	35.00%	Limited Consolidation
20	Baroda Gujarat Gramin Bank	35.00%	Limited Consolidation
21	Indo-Zambia Bank Limited	20.00%	Limited Consolidation

Source: *BoB*

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