Canara Bank

Instruments	Amount (Rs. Crore)[1]	Rating Action (December 2016)
Additional Tier-I Bonds Programme – Basel III	1,500	[ICRA]AA (hyb) (negative); reaffirmed
Tier-II Bonds Programme – Basel III	7,900	[ICRA]AAA (hyb) (negative); reaffirmed
Lower Tier II Bonds Programme	2,000	[ICRA]AAA (negative); reaffirmed
Certificate of Deposits Programme	50,000	[ICRA]A1+; reaffirmed

ICRA has reaffirmed the long-term rating of [ICRA]AA (hyb) (pronounced ICRA double A hybrid) for the Rs. 1,500 crore Basel III compliant additional tier-1 bond programme, [ICRA]AAA(hyb) (pronounced ICRA triple A hybrid) rating for the Rs. 7,900 crore Basel III compliant tier-II bond programme and the [ICRA]AAA (pronounced ICRA triple A) rating for the Rs. 2,000 crore lower tier-II bond programme of Canara Bank (Canara)[2]. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 50,000 crore certificate of deposits programme of the bank. The outlook on the long-term rating is negative.

The letters “hyb” in parenthesis suffixed to a rating symbol stand for “hybrid”, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss-severity vis-à-vis conventional debt instruments.

The rating for the bank’s Basel III compliant tier I bonds is two notches lower than the Basel III complaint tier II bonds as these instruments have the following loss absorption features that make them riskier:

- The bank has full discretion at all times to cancel the distribution or payments and the cancellation shall not be an event of default
- The minimum capital conservation ratio applicable to commercial banks may restrict the bank from servicing these tier I bonds in case the common equity tier-I falls below the limit prescribed by the RBI

These tier I bonds are expected to absorb losses through the write-down mechanism at the objective pre-specified trigger point fixed at the bank’s common equity tier-I ratio, as prescribed by the RBI. The ratio is 5.5% till March 2019 and thereafter 6.125% of the total risk weighted assets of the bank or when the point of non-viability (PONV) trigger is breached in the RBI’s opinion.

The rating action factors in the bank’s sovereign ownership (66.3% stake held by the Government of India as on September 30, 2016), its established franchise network that supports its deposit profile and liquidity (liquidity coverage ratio was at 85% for FY2016). The rating also factors in the deterioration in the bank’s asset quality and profitability indicators over the last 12 months and sizeable capital requirement to support its business growth over the medium term.

The bank’s gross NPAs increased sharply from 4.3% as on September 30, 2015 to 9.4% as on March 31, 2016 on account of the RBI’s asset quality review. However, during H1FY2017, with lower incremental slippages, the gross NPAs increased only marginally to 9.8% as on September 30, 2016. The increase in NPAs has weakened the bank’s solvency[3] to 81.9% as on September 30, 2016 (31.3% as on September 30, 2015), thus limiting its ability to withstand any unforeseen future losses. The share of bank’s standard restructured assets (excluding state electricity boards) in gross advances came down to 3.4% as on September 30, 2016 (5.0% as on September 30, 2015). Expected moderation in incremental slippages, focussed recovery efforts and likely equity infusion in the near term would support the bank’s overall credit profile.

On account of the slippages and NPA ageing, Canara’s credit cost[4] stood high at 1.9% for FY2016 as against 0.3-0.7% reported during the last five fiscals, resulting in net losses for FY2016 (RoA[5] at -0.5%). However, the

[1] Rs. 1 crore = Rs. 10 million = Rs. 100 lakh
[2] For complete rating scale and definitions, please refer to ICRA’s website (www.icra.in) or other ICRA rating publications
[3] Net NPA / Net-worth excluding revaluation reserves
[4] Credit provisions / average total assets
[5] Return on average assets

credit costs for H1FY2017 reduced to 1.1% due to lower slippages, aiding the bank to report profits for H1FY2017 (RoA at 0.2%). Going forward, with NPA ageing and the expected improvement in provision coverage[6] (34% as on September 30, 2016), the bank's credit costs would remain high. That being said, the bank's ability to control incremental slippages and undertake effective recoveries would be crucial from a profitability perspective.

The bank has a moderate capitalization profile with tier-1 capital at 8.9% (CET-1 at 8.3%) as on September 30, 2016 compared to peer banks, as against the minimum regulatory tier-1 capital requirement of 9.5% (CET-1 of 8.0%) by March 2019[7]. As per ICRA's estimate, the bank's incremental total tier-1 capital requirement till FY2019 is sizable at Rs. 11,000 – 14,000 crore[8]. ICRA takes notes of the government's commitment to infuse capital of Rs. 997 crore during current fiscal and the bank's proposed rights issue of about Rs. 1,128 crore in the near term, which would strengthen its capital and solvency profile in relation to the envisaged business growth and corresponding risks.

As on September 30, 2016, the bank's gross advances witnessed modest growth of 3.4% y-o-y on account of a 9% decline in its corporate advances; corporate advances as a proportion of gross advances declined from 47% as on September 30, 2015 to 42% as on September 30, 2016. ICRA expects this shift towards non-corporate segments to support the bank's business yields and improve its credit risk profile. While the bank's total deposits remained broadly at the same level during the 12 month period ending September 2016, its deposit profile witnessed improvement, with the share of CASA deposits increasing from 23.9% to 27.2% and the share of retail term deposits increasing from 33.0% to 38.7% during the period.

Bank Profile

Canara is a large nationalised bank in the country, with majority ownership with the GoI (stake of 66.30% as on September 30, 2016). Headquartered in Bangalore, Canara has a pan-India presence, directly through its branch network of 5,868 branches and through its seven subsidiaries, an associate company and a joint venture. The group provides a wide range of financial offerings including asset management, online trading, factoring and housing finance. As on September 30, 2016, the bank had a 7.5 crore strong client base.

Recent Results

During FY2016, Canara reported a net loss of Rs. 2,813 crore on a total asset base of Rs. 5.5 lakh crore as compared with a net profit of Rs. 2,703 crore on an asset base of Rs. 5.4 lakh crore during FY2015.

During H1FY2017, the bank reported a net profit of Rs. 586 crore on a total asset base of Rs. 5.6 lakh crore as compared with a net profit of Rs. 1,008 crore on an asset base of Rs. 5.5 lakh crore during H1FY2016.

December 2016

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[6] (Gross NPA – Net NPA) / Gross NPA
[7] Including capital conservation buffer
[8] Assuming a buffer of 1.0% over and above the regulatory minimum requirement and an annualized growth of 8-9% in risk weighted assets and internal generation (net of dividends) of 6-7% during FY2017-FY2019

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