June 28, 2017

Bank of Maharashtra (Revised)

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Basel II Compliant Lower Tier II Bonds	1,130	[ICRA]AA-(Negative); Downgraded from [ICRA]AA (Negative)
Basel II Compliant Upper Tier II Bonds	400	[ICRA]A+ (Negative); Downgraded from [ICRA]AA-(Negative)
Basel II Compliant Innovative Perpetual Debt Instrument	70	[ICRA]A+ (Negative); Downgraded from [ICRA]AA-(Negative)
Basel III Compliant Tier II Bonds Programme	1,000	[ICRA]AA-(hyb) (Negative); Downgraded from [ICRA]AA(hyb) (Negative)
Basel III Compliant Tier I Bonds	1,000	ICRA]A- (hyb) (Negative); Downgraded from [ICRA]A(hyb) (Negative)
Basel II Compliant Lower Tier II Bonds	20	[ICRA]AA-(Negative); Downgraded from [ICRA]AA (Negative) and withdrawn
Basel II Compliant Upper Tier II Bonds	50	[ICRA]A+ (Negative); Downgraded from [ICRA]AA-(Negative) and withdrawn
Basel II Compliant Innovative Perpetual Debt Instrument	30	[ICRA]A+ (Negative); Downgraded from [ICRA]AA-(Negative) and withdrawn

*Instrument details are provided in Annexure-1

Rating action

ICRA has downgraded the ratings for the Rs. 1,130 crore Basel II Compliant Lower Tier II Bonds Programme of Bank of Maharashtra (BOM)[1] to [ICRA]AA- (pronounced ICRA double A minus) from [ICRA]AA (pronounced ICRA double A) and for the Rs. 1,000 crore Basel III Compliant Tier II Bonds Programme to [ICRA]AA-(hyb) (pronounced ICRA double A minus hybrid) from [ICRA]AA(hyb) (pronounced ICRA AA hybrid). ICRA has also downgraded the ratings for the bank's Rs. 400 crore Basel II Compliant Upper Tier II Bonds and the Rs. 70 crore Basel II Compliant Innovative Perpetual Debt Instruments to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]AA- (pronounced ICRA double A minus). ICRA has also downgraded the bank's Rs. 1,000 crore Basel III Compliant Tier I Bonds to [ICRA]A-(hyb) (pronounced ICRA A minus hybrid) from [ICRA]A(hyb) (pronounced ICRA A hybrid). The outlook on the ratings is negative.

ICRA has also downgraded and withdrawn the ratings for the Rs. 20 crore Basel II Compliant Lower Tier II Bonds Programme to [ICRA]AA- from [ICRA]AA and the Rs. 50 crore Basel II Compliant Upper Tier II Bonds and the Rs. 30 crore Basel II Compliant Innovative Perpetual Debt Instruments to [ICRA]A+ from [ICRA]AA- . The ratings have been withdrawn as they have not been utilised by the bank.

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

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 Basel III Compliant Tier I bonds is three notches lower than the Basel III Complaint Tier II bonds of the bank as these Tier I instruments have the following loss absorption features that make them riskier.

- The bank has the full discretion at all times to cancel distribution or payments and the cancellation of discretionary payments shall not be an event of default.
- The minimum capital conservation ratio applicable to banks may restrict the bank from servicing these Tier I bonds in case the Common Equity Tier-I (CET-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 (CET-I) ratio as prescribed by the RBI – 5.5% till March 2019 and thereafter 6.125% of total risk weighted assets of the bank or when the "Point of Non-Viability" trigger is breached in the RBI's opinion.

Basel III compliant Tier I bonds also have the following features, which make them riskier.

- Coupon payments, which are non-cumulative, are discretionary and the bank has the full discretion at all times to cancel them.
- Coupon can be paid out of current year profits. However, if the current year profit is not sufficient, or, if the payment of coupon is likely to result in a loss, the coupon payment can be made through reserves and surpluses created through 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 capital conservation buffer, CCB) at all times as prescribed by the RBI under Basel III regulations.

Rationale

The ratings downgrade takes into account BOM's weak operating and financial performance during FY2017, as reflected in its increasing non-performing assets (NPA) and net losses during the year resulting in a significant weakening of its solvency[2] levels. The ratings downgrade and negative outlook also take into account ICRA's weak outlook on the bank's profitability amid its high levels of NPAs and low provisioning cover as well as the increased capital requirement to meet the Basel III regulations.

The bank's asset quality deteriorated significantly in FY2017 with gross and net NPAs of 16.93% and 11.76% respectively as on March 31, 2017 as compared with 9.34% and 6.35% as on March 31, 2016. At 35% as on March 31, 2017, the bank had one of the lowest provision coverage ratios[3] in the industry. With high slippages, the bank's operating profitability also remained subdued which coupled with the high credit costs resulted in net losses. Consequently, the bank's solvency ratio weakened significantly to 182% as on March 31, 2017 from 91% as on March 31, 2016. Given the current low provisioning coverage, ICRA expects the bank's credit costs to remain high over the next two years on account of both incremental slippages and ageing of current NPAs. This will result in profitability pressures remaining

[2]Net NPA/Net worth

[3] Excluding prudential and technical write-offs; ~45% including prudential and technical write-offs

high in the near to medium term. Further, while the bank's capitalisation (CET-1 of 7.28%, Tier 1 of 9.01% and CRAR of 11.18% as on March 31, 2017 as against regulatory requirement of 6.75%, 8.25% and 10.25% respectively) meets the regulatory minimum levels, there is limited cushion available. With profitability expected to remain under pressure, as per ICRA's estimates, BOM would need to raise CET of around ~Rs. 2,000-3,000 crore[4] (about 50-75% of its current market capitalisation) during FY2018 to FY2019 to meet the minimum regulatory capital requirements. These capital estimates will also increase to the extent of the losses reported by the bank during the projected period. With the GoI holding 81.61%[5] of the equity as on March 31, 2017, the bank has headroom to raise capital from non-government sources; BOM's ability to raise capital from government and non-government sources will have strong bearing on its ability to meet the minimum capital requirement levels. In June 2017, the Reserve Bank of India (RBI) included BOM under the prompt corrective action (PCA) framework given the bank's high net NPAs. ICRA notes that the bank is likely to be placed in one of the higher risk threshold levels, necessitating various mandatory and discretionary corrective actions under the PCA framework.

The ratings continue to draw comfort from BOM's majority sovereign ownership and its strong franchise in Maharashtra which has resulted in a healthy and stable deposits base.

Key rating drivers

Credit strengths

- Majority GoI ownership (81.61%[6] as on March 31, 2017); demonstrated support from the GoI in the form of regular equity infusion (Rs. 300 crore in FY2017 and Rs. 394 crore in FY2016) provides comfort
- Strong retail franchise with widespread branch network of over 1,897 strengthens the deposits profile; CASA remains strong at 45% as on March 31, 2017
- Comfortable liquidity position backed by a high proportion of retail deposits

Credit weaknesses

- Significant deterioration in asset quality with an increase in gross NPAs to 16.93% as on March 31, 2017 from 9.34% as on March 31, 2016
- Sharp deterioration in solvency, with net NPA/net worth increasing to 182% as on March 31, 2017 from 91% as on March 31, 2016
- Weak profitability with profit after tax /average total assets of -0.87% in FY2017, largely on account of high credit costs and high interest reversals
- Low capital cushion with CET 1 at 7.28% as against regulatory minimum requirement of 6.75% by March 31, 2017; sizeable capital required to meet the higher regulatory requirements[7] under Basel III norms

Description of key rating drivers

BOM's asset quality deteriorated sharply in FY2017 with high slippages of 9.04% resulting in gross and net NPAs increasing to 16.93% and 11.76% respectively as on March 31, 2017 from 9.34% and 6.35% respectively as on March 31, 2016. The bank's gross and net NPA as at March 31, 2017 were

[4]Assuming an RWA growth of ~5-10% during FY2018 to FY2019 and a buffer of 0.5% over regulatory capital requirements
[5]After allotment of shares for fresh infusion of Funds of Rs. 300 crore, the GoI holding will increase to 82.91%
[6] After allotment of shares for fresh infusion of Funds of Rs. 300 crore, the GoI holding will increase to 82.91%
[7] Assuming an RWA growth of ~5-10% during FY2018 to FY2019 and a buffer of 0.5% over regulatory capital requirements

considerably higher than the PSB average of 11.4% and 6.8% respectively. The bank's provision coverage ratio at ~35% as on March 31, 2017 remains among the lowest in the industry. With the increase in NPAs and losses far exceeding the capital infusion during the year, the bank's solvency ratio weakened significantly to 182% as on March 31, 2017 from 91% as on March 31, 2016 and is also among the weakest in the industry. The deterioration in BOM's solvency profile reflects its lower ability to withstand profitability pressures, going forward. BOM's ability to resolve stressed accounts and create a capital buffer would be critical for its credit profile. The stock of standard assets under standstill clause under various schemes for resolution of stressed assets[8] is estimated at 4.7% of net advances as on March 31,2017; ICRA hence, expects the bank's asset quality pressures and credit costs to remain elevated in the near to medium term.

With high NPAs and the consequent decline in earning assets, the bank's net interest income declined by 18% in FY2017. The bank's net interest margins[9] (NIMs) were lower at 2.00% of ATA[10] during FY2017 (2.55% in FY2016). The operating expenses, however, increased to 1.80% of ATA in FY2017 (1.68% in FY2016). With lower NIMs and higher operating expenses, the bank's core operating profitability declined to 0.79% of ATA in FY2017 (1.44% in FY2016). Further, with the elevated credit costs (2.40% in FY2017 as compared with 1.26% in FY2016), the bank reported a net loss of 0.87% of ATA as compared with a net profit of 0.07% in FY2016. High levels of losses have also significantly eroded the bank's distributable reserves, which can be used to service the coupon on its Additional Tier-I (AT-I) bonds. As per ICRA's estimates the distributable reserves[11] stood at 2.2% of RWA as on March 31, 2017 as against 3.3% as on March 31, 2016. While the bank's profitability is expected to remain under pressure in the near to medium term, any further erosion of the distributable reserves will be an additional rating sensitivity for the AT-1 bonds.

While the bank's capitalisation levels (CET-1 of 7.28%, Tier 1 of 9.01% and CRAR of 11.18% as on March 31, 2017 as against regulatory requirement of 6.75%, 8.25% and 10.25% respectively) meet the regulatory minimum, there is limited cushion available. The bank received an equity infusion of Rs. 300 crore in FY2017 from the GoI and also raised Tier-I capital of Rs. 500 crore during FY2017 through perpetual AT-1 bonds. The cumulative outstanding stood at Rs. 1,500 crore (1.6% of RWA) as on March 31, 2017.As per ICRA's estimates, BOM would need to raise CET 1 of around ~Rs. 2,000-3,000 crore[12] (about 50-75% of its current market capitalisation) during FY2018 to FY2019 to meet the minimum regulatory capital requirements. These capital estimates will also increase to the extent of the losses reported by the bank during the projected period. Given the GoI shareholding at 81.61%[13] as on March 31, 2017, the bank has considerable scope to raise capital from non-government sources while maintaining the GoI shareholding above 51%.

The bank's gross advances stood at Rs.1,01,537 crore as on March 31, 2017 as compared with Rs. 1,11,240 crore as on March 31, 2016 representing a significant de-growth of 9% in FY2017 (4% growth in FY2016). The slowdown followed the bank's cautious approach in lending to the corporate segment amid the high NPAs, its focus on recoveries and capital preservation, and the subdued credit demand in the domestic market. PSBs overall registered a credit growth of around 1% in FY2017. With higher growth in the retail and agri segments, the share of corporate segment in the bank's advances declined to

[8] Standard restructured, 5/25 refinancing, SDR and S4A
[9] As per ICRA calculations
[10] Total Assets excluding revaluation reserves
[11] As per RBI guidelines revised in February 2, 2017
[12] Assuming an RWA growth of ~5-10% during FY2018 to FY2019 and a buffer of 0.5% over regulatory capital requirements
[13] After allotment of shares for fresh infusion of Funds of Rs. 300 crore, the GOI holding will increase to 82.91%

50.5% as on March 31, 2017 from 59.9% as on March 31, 2016, while the share of retail increased to 15.6% from 11.3%, agriculture increased to 15.3% from 13.4% and MSME increased to 18.6% from 15.4% during the period. The decline in net loans resulted in a drop in the bank's RWA by 6.1% during FY2017 which in turn supported its capital ratios.

Supported by an increase in deposits post demonetisation, the bank's CASA ratio increased to 44.89% as on March 31, 2017 from 34.67% as on March 31, 2016, leading to a decline in its cost of interest bearing funds to 6.03% in FY2017 from 6.53% in FY2016. The bank's CASA ratio remains higher than the PSB average of 36.7% as on March 31, 2017. The deposit base is supported by the bank's established franchise and wide branch network. As at March 31, 2017, the bank had 1,897 branches and 1,878 ATMs.

BOM's liquidity profile was comfortable without any mismatches in the short term buckets up to 6 months, while negative mismatches existed in the 6-12 month and 1-3 year buckets as on March 31, 2017. The bank's liquidity is also supported by its sizeable SLR and non-SLR investments at 24% of total assets as on March 31, 2017, which can be used in case of a liquidity strain.

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

Links to applicable criteria
ICRA Rating Methodology for Banks
ICRA Rating Methodology for Basel III Compliant Non-Equity Capital Instruments

About the company
The bank was registered in 1935 at Pune, Maharashtra as a public limited company by the name, The Bank of Maharashtra Ltd. with the objective of assisting small business enterprises, traders, self-employed and other common men. Subsequently, with increasing scale of operations, it became a scheduled bank in 1944 and acquired four small banks (Bank of Konkan Ltd., Bank of Nagpur Ltd., Bharat Industrial Bank Ltd and Banthia Bank Ltd) to expand its business operations. BOM was nationalised along with 13other banks, in July 1969.

The bank had a wide network of 1,897 branches largely spread across Maharashtra as on March 31, 2017. During FY2017, the bank reported a net loss of Rs. 1,373 crore on a total asset[14] base of Rs. 158,118 crore as on March 31, 2017 as against a net profit of Rs. 101 crore on a total asset base of Rs. 159,067 crore as on March 31, 2016. BOM's gross and net NPAs stood at 16.93% and 11.76% as on March 31, 2017. The bank reported Tier I capital of 9.01% and CRAR of 11.18% as on March 31, 2017.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

[14] Total Assets excluding revaluation reserves

Rating history for last three years:

Table:

Sr. No.	Instrument	Type	Rated Amount (Rs. crore)	Outstanding Amount (Rs. crore)	Current Rating (FY2018) June 2017	Chronology of rating history for the past 3 years FY2017 Oct 2016	FY2016 Jan 2016	FY2016 Oct 2015	FY2015 Dec 2014
1	Basel II compliant Lower Tier II Bonds	Long Term	1,130	1,130	[ICRA]AA- (Negative); Downgraded from [ICRA]AA (Negative)	[ICRA]AA (Outlook revised to Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable); Downgraded from [ICRA]AA+ (Stable)	[ICRA]AA + (Stable)
2	Basel II compliant Upper Tier II Bonds	Long Term	400	400	[ICRA]A+ (Negative); Downgraded from [ICRA]AA- (Negative)	[ICRA]AA- (Outlook revised to Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable); Downgraded from [ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Basel II compliant Innovative Perpetual Debt Instrument	Long Term	70	70	[ICRA]A+ (Negative); Downgraded from [ICRA]AA- (Negative)	[ICRA]AA- (Outlook revised to Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable); Downgraded from [ICRA]AA (Stable)	[ICRA]AA (Stable)
4	Basel III Compliant Tier II Bonds Programme *	Long Term	1,000	500	[ICRA]AA-(hyb) (Negative); Downgraded from [ICRA]AA(hyb) (Negative)	[ICRA]AA(hyb) (Outlook revised to Negative)	[ICRA]AA(hyb) (Stable)	-	-
5.	Basel III Compliant Tier I Bonds*	Long Term	1,000	500	ICRA]A- (hyb) (Negative); Downgraded from [ICRA]A(hyb) (Negative)	[ICRA]A(hyb) (Negative)	-	-	-

**Rs. 500 crore is untutilised amount*

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

<u>Instrument Details</u>

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
Basel II compliant Lower Tier II Bonds	30-Sep-2009	8.74%	30-Apr-2019	130.00	[ICRA]AA-(negative)
Basel II compliant Lower Tier II Bonds	31-Dec-2012	9.00%	31-Dec-2022	1000.00	[ICRA]AA-(negative)
Basel II compliant Upper Tier II bonds	30-Sep-2009	8.95%	30-Sep-2024 (Call: 30-Sep-2019)	100.00	[ICRA]A+(negative)
Basel II compliant Upper Tier II bonds	01-Feb-2010	8.65%	01-Feb-2025 (Call: 01-Feb-2020)	300.00	[ICRA]A+(negative)
Basel II compliant Innovative Perpetual Debt Instrument	30-Sep-2009	9.25%	Perpetual (Call: 30-Sep-2019)	70.00	[ICRA]A+(negative)
Basel III compliant Tier II bonds	27-Jun-2016	9.20%	27-Sep-2026	500.00	[ICRA]AA-(hyb)(negative)
Basel III compliant Additional Tier I	15-Dec-2016	11.60%	Perpetual (Call: 15-Dec-2021)	500.00	[ICRA]A-(hyb)(negative)
Basel III compliant Tier II bonds^	-	-	-	500	[ICRA]AA-(hyb)(negative)
Basel III compliant Additional Tier I^	-	-	-	500	[ICRA]A-(hyb)(negative)

^Yet to be placed

Source: BOM

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