October 03, 2017

Bank of Baroda

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Basel III Complaint Tier II Bonds Programme	1,000.00	[ICRA]AAA(hyb)(stable); reaffirmed
Medium Term Deposits	-	MAAA(stable); reaffirmed

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the rating of [ICRA]AAA(hyb) (pronounced ICRA triple A hybrid) for Rs. 1,000 crore Basel III compliant Tier II bonds programme of Bank of Baroda (BOB)[1]. ICRA has also reaffirmed the ratings of MAAA (pronounced M triple A) for the medium term deposits programme of BOB. 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.

Rationale

The ratings factor in BOB's majority sovereign ownership (59.24% equity shares are held by Government of India or GoI as on June 30, 2017), comfortable capitalisation, its strong franchise imparting healthy and stable deposits base and sound liquidity profile. BOB has a healthy deposits profile supported by its wide spread branch network and well established brand franchise (more than 5400 branches and 10,000 ATMs & Cash Recyclers), BOB's domestic current account and saving account (CASA) deposits were ~ 39% as on June 30, 2017 which is a positive from cost of funds as well as liquidity perspective.

ICRA has taken note of the bank's weak asset quality (gross and net NPA of 11.40% and 5.17% respectively as on June 30, 2017) resulting in high credit provisions and subdued profitability (profit after tax (PAT) % of Average Total Assets (ATA) of 0.20% in FY2017 and 0.12% in Q1FY2018). ICRA, however, takes comfort from BOB's provision coverage of 57.7% as on June 30, 2017 being the highest in the industry (Public sector bank's (PSB) average of 43% as on June 30, 2017). With high provision coverage, the solvency ratio for the bank stood weak at 52.9% as on June 30, 2017 but better as compared to PSB average of 83%. High provision coverage is also expected to provide cushion to the net profitability as the stressed accounts undergo resolution. ICRA expects the fresh slippages to remain high in FY2018, however supported by recoveries and upgrades, the overall asset quality numbers, provision coverage and solvency ratio are likely to remain similar level to March 2017 levels.

Key Rating sensitivities:

- **Capitalisation –** While the capitalisation levels are comfortable in relation to Basel III capital requirements as on March 31, 2019, these are weak in relation to the rating category. Inability to raise capital and weakening of capital cushions will be rating negative.

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

- **Asset Quality –** ICRA expects the overall asset quality numbers, i.e. GNPA, Net NPAs, provision coverage and solvency ratios to large remain stable by end of FY2018 as compared to end of FY2017. As per out estimates, the credit provisions are expected to be 1.15%-1.20% of ATA during FY2018. A weaker than expected performance on asset quality will be a rating negative.

Key rating drivers

Credit Strengths

- **Sovereign ownership -** The bank is majority owned by GoI with shareholding at 59.24% as on June 30, 2017. While the bank has not received equity from the government in the last financial year due to the comfortable capitalisation of the bank; however ICRA expects support from GOI, if required.
- **Standing in the Indian financial system, by virtue of being among the largest PSBs in terms of total asset base -** BOB is the third largest PSB and the fifth largest bank in the Indian banking sector, accounting for 5.1% of the gross advances and 5.5% of the deposits as on June 30, 2017. BOB's market position is supported by its strong franchise, including a large network of 5,434 branches across India.
- **Capitalisation profile remains adequate for current scale of operations, ability to improve capitalisation critical for rating level -** The bank's capitalisation levels (CET1 of 8.83%, Tier 1 of 9.77% and CRAR of 11.81% as on June 30, 2017 as against regulatory requirement of 7.375%, 8.875% and 10.875% respectively as on March 31, 2018) remain comfortable. While capital levels are adequate for current scale of operations and basel III requirements as on March 31, 2019, however capital cushion has been weakening consistently because of weak internal capital generation and growth in advances. As per ICRA's estimates, while the bank does not require capital during FY2018[2], the bank will require equity capital of ~Rs. 4,500 – Rs. 5,000 crore during FY2019. Given the current GoI shareholding of 59.24% and capital required being 13-15% of market capitalization, BoB is relatively better placed among PSBs to raise capital with no dependence on GoI. Additionally, the bank would require a total of ~Rs 2000-2500 crore additional tier I (AT-I) capital during FY2018 and FY2019 (of which bank has already raised Rs 1350 crore in Q2FY2018). Ability to raise the equity capital and improve capital cushions will remain critical for the rating level.
- **Well developed deposit franchise with adequate CASA deposit base -** The bank has a well developed franchise resulting into comfortable CASA. During FY2017, the share of CASA in the bank's deposit profile improved sharply, driven by a growth in both current account (CA) and savings account (SA) deposits following demonetisation. The increase in CASA% was also supported by the bank's stable credit book, reducing the need to raise bulk deposits. As on March 31, 2017, the share of CASA in total deposits stood at 32% vis-à-vis 26% as on March 31, 2016. Domestic CASA % for the bank was higher at ~39% as on March 31, 2017 (compared to PSB average of 37% as on March 31, 2017).
- **Comfortable liquidity profile -** The bank had a comfortable liquidity coverage ratio of 129.4% as on March 31, 2017 as against the regulatory requirement of 90% as on January 01, 2018. ICRA expects BOB to maintain comfortable liquidity given its large proportion of retail deposits and strong financial flexibility. The bank is also likely to receive support from the RBI (through Repo and Marginal Standing Facility mechanism) in case of urgent liquidity needs.

[2] Assuming a 1% buffer over regulatory capital levels and 10% growth in risk weighted assets

Credit weaknesses

- **Slippages expected to remain high, however incremental weakness in asset quality numbers likely to remain minimal FY2018 -** While the fresh NPA generation rate continued to remain elevated (4.7% in FY2017), it was largely offset by the high recoveries, upgradations and write-offs. Consequently, the gross NPA% for the bank increased marginally to 10.5% as on March 31, 2017 (10.0% as on March 31, 2016). BOB's improved its provision coverage ratio to 58% as on March 31, 2017 from 52% as on March 31, 2016 and was higher than PSB average of 44% as on March 31, 2017. With the increase in provision cover, the Net NPA% for the bank reduced to 4.7% as on March 31, 2017 as compared to 5.1% as on March 31, 2016 and the solvency ratio improved to 49.2% (PSB average of 75% as on March 31, 2017) as compared to 53.8% in the previous year. The slippages continued to remain elevated during Q1FY2018 with gross NPA% and Net NPA% increasing to 11.4% and 5.2% as on June 30, 2017 with solvency level of 52.8%. As per ICRA estimates, the bank's stock of vulnerable exposures[3] is estimated at 4.5% of gross advances as on June 30, 2017; hence we expect the fresh slippages will continue to remain elevated during FY2018. However with a recoveries, upgradations and write-offs assumption similar to FY2017, we expect the asset quality numbers by end of FY2018 to remain similar level to March 2017 levels. Any material weakness in the asset quality will remain as a rating sensitivity.
- **Profitability expected to remain weak because of elevated credit provisioning requirements – S**upported by decline in cost of interest bearing funds, NIMs improved marginally to 1.99% in FY2017 vs 1.84% of ATA in FY2016. With limited incremental deterioration in asset quality, the credit provisions also stood lower at 1.24% during FY2017 vs 1.96% during FY2016. While the credit provisions declined in FY2017, they remained high as reflected in weak profitability with PAT % of ATA and Return on net worth (RoNW) of 0.20% and 3.8% respectively during FY2017. ICRA expects the credit provisions to remain high at 1.15%-1.20% of ATA during FY2018; however these are likely to be absorbed through the operating profits and gains from sale of investments but will continue to result in weak net profitability in near term.

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

About the bank

BOB was incorporated in 1908 and was under private ownership and control till July 1969 when it was nationalized along with 13 other banks. Government of India held 59.24% stake in the bank as on Jun 30, 2017. The bank has a wide spread domestic network of 5,434 branches across India (as on June 30, 2017) and a large overseas presence with 107 offices. During the year ended March 31, 2017, BoB reported a net profit of Rs. 1,383 crore on total assets of Rs.6.91 lakh crore as compared to a net loss of Rs. 5,396 crore on total assets of Rs. 6.67 lakh crore during the previous year. The bank's Gross NPA% and Net NPA% stood at 10.46% and 4.72% respectively as on March 31, 2017 as against 9.99% and 5.06% respectively, as on March 31, 2016. The regulatory capital adequacy ratio stood at 12.24% as on March 31, 2017 (Tier 1: 9.93% and CET 1 of 8.98%). The bank reported a PAT of Rs. 203 crore in Q1FY2018 as compared to Rs.424 crore in Q1FY2017. The gross and net NPA% stood at 11.40% and 5.17% respectively as on June 30, 2017.

[3] Includes vulnerable standard accounts and vulnerable accounts under various schemes of restructuring

Key Financial Indicators:

	FY2016	**FY2017**	**Q1FY2017**	**Q1FY2018**
Net Interest Income	12,740	13,513	3,371	3,405
Profit before tax	-6,698	2,473	665	280
Profit after tax	-5,396	1,383	424	203
Net advances	383,770	383,259	362,766	377,607
Total assets	667,250	691,299	657,655	660,906
% CET 1	10.29%	8.98%	10.19%	8.83%
% Tier 1	10.79%	9.93%	10.70%	9.77%
% CRAR	13.17%	12.24%	13.07%	11.81%
% Net Interest Margin / Average total assets	1.84%	1.99%	2.04%	2.01%
% Net Profit / Average total assets	-0.78%	0.20%	0.26%	0.12%
% Return on Net Worth	-14.40%	3.80%	4.67%	2.21%
% Gross NPAs	9.99%	10.46%	11.15%	11.40%
% Net NPAs	5.06%	4.72%	5.73%	5.17%
% Provision coverage excl. technical write offs	52.11%	57.68%	51.66%	57.73%
% Net NPA/ Net worth	53.80%	49.23%	56.95%	52.85%

Source: Bank's investor presentation and ICRA research; Amount in Rs. crore
All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years:
Table:

Sr. No.	Name of Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years						
		Type	Rated amount (Rs. crore)	Oct 2017	Jun 2017	FY2017	FY2016		Fy2015			
						Jul 2016	Jul 2015	April 2014	Dec 2013	Jul 2013	April 2013
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	-	-
2	Term Deposits Programme	Long Term	NA	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)
3	Basel II Compliant Tier II Bonds Programme	Long Term	-	-	-	[ICRA] AAA (stable) withdrawn	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)
4	Certificate of Deposit Programme	Short Term	-	-	[ICRA] A1+ withdrawn	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
5	Corporate Governance Rating	-	-	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2

Source: ICRA

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-

<u>Instrument Details</u>

ISIN No.	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE028A08059	Basel III Compliant Tier II Bonds Programme	17-Dec-2013	9.73%	17-Dec-2023	1,000	[ICRA]AAA (hyb) (stable)
NA	Medium Term Deposits	-	-	-	-	MAAA(stable)

Source: BOB

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