Central Bank of India

August 07, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Lower Tier II bonds programme	500.00	500.00	[ICRA]A+(negative); outstanding
Upper Tier II bonds programme	285.00	285.00	[ICRA]A- &, placed on rating watch with developing implication
Upper Tier II bonds programme	500.00	500.00	[ICRA]A- &, placed on rating watch with developing implication
Upper Tier II bonds programme	500.00	500.00	[ICRA]A- &, placed on rating watch with developing implication
Upper Tier II bonds programme	1,000.00	1,000.00	[ICRA]A- &, placed on rating watch with developing implication
Total	**2,785.00**	**2,785.00**	

& Under Rating Watch with Developing Implications

Material event

Central Bank of India (CBI) announced its quarterly results on July 30, 2018. The bank reported a loss after tax of Rs. 1,522 crore during Q1 FY2019 compared to a loss after tax of Rs. 577 crore in Q1 FY2018 and Rs. 5,105 crore in FY2018. With continuing losses and no fresh equity capital infusion and lack of significant reduction in risk-weighted assets (RWA) during Q1 FY2019, the capital to risk-weighted ratio (CRAR) and Tier I ratio deteriorated below the regulatory levels of 9.00% and 7.00%, respectively, to 8.05% and 6.05%, respectively, as on June 30, 2018 (9.04% and 7.01%, respectively, as on March 31, 2018).

Rating action

ICRA has placed the rating of [ICRA]A- (pronounced ICRA A minus) for the Rs. 2,285.00-crore upper Tier II Bonds programme of CBI on Rating Watch with Developing Implications (RWD). ICRA also has an outstanding rating of [ICRA]A+ (pronounced ICRA A plus) on the Rs. 500.00-crore lower Tier II bonds programme of CBI[1]. ICRA believes that the rating on the lower Tier II bonds programme is likely to remain unchanged and has not placed it on RWD. The outlook on the long-term rating of the lower Tier II bonds programme is Negative.

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

Rationale

The ratings on the upper Tier II bonds programme were placed on RWD due to the deterioration in the capital adequacy ratios, which were below the regulatory levels. Maintaining the capital ratios above regulatory levels is critical for servicing the bank's Basel II debt capital instruments[2]. Earlier in May 2018 (Click here for the previous rationale), ICRA had highlighted the bank's weak capital ratios and had noted that CBI will require regular capital infusion from the Government of India (GoI) to keep its capital ratios above regulatory levels. In addition to regularly infusing capital into most public sector banks (PSBs) during the last few years, the GoI recently (July 2018) supported five PSBs with a capital infusion of Rs. 11,336 crore, to shore up their capital ratios and enable them to service their debt capital instruments as per the covenants of these instruments. While this reinforces the sovereign support for PSBs, CBI has not received any capital during FY2019 (YTD). Accordingly, timely capital infusion before the coupon payment dates will be critical for the bank.

With the gross non-performing advances (NPA) ratio and net NPA ratio at 22.17% and 10.58%, respectively, as on June 30, 2018, ICRA estimates that CBI will continue to post a net loss during FY2019, as credit costs will remain above operating profits during the year. With the expected losses, the bank would require additional equity support from the GoI on a regular basis to meet the minimum capital requirements (7.00% Tier 1 and 9.00% CRAR) for servicing the coupon on Basel II instruments.

As per ICRA's estimates, given the expected loss in FY2019 and assuming a 15% reduction in RWA levels, CBI will require Tier I capital of ~Rs, 6,000-8,000 crore (33-44% of the market cap) to meet the regulatory capital requirement (including capital conservation buffer (CCB) of 2.5% and additional buffer of 50 bps) as on March 31, 2019. If the bank does not maintain the CCB but maintains a CET I/Tier I capital of 7.25-7.50%, and hence CRAR of > 9.0%, the equity capital requirement is expected to be lower at Rs. 2,000-4,000 crore (11-22% of the market cap). ICRA will closely monitor the impact of any measures or actions taken by the bank or the GoI with respect to CBI's capitalisation profile and will resolve the rating watch depending on the quantum of capital raised by the bank. Ability to raise sufficient capital in a timely manner to keep capital ratios above regulatory levels on a sustained basis will resolve the rating watch.

The ratings continue to factor in CBI's majority sovereign ownership (86.40% of the equity shares were held by the GoI as on June 30, 2018), its well-developed deposit franchise with a healthy CASA deposit base, and sound liquidity profile.

Outlook: Negative

In ICRA's opinion, the bank's profitability, and consequently its capital position is expected to remain weak. The outlook may be revised to Stable if there is a significant improvement in its capitalisation, solvency and asset quality indicators. The ratings may be downgraded if the bank is unable to raise sufficient capital in a timely manner to augment the capital adequacy ratios, thereby impacting its ability to service its debt capital instruments.

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[2] *Innovative perpetual debt instruments (IPDI) and upper Tier II bonds – in a year of loss, the capital instruments can be serviced with prior approval from the RBI subject to the bank meeting minimum regulatory capital ratios (tier I of 7.0% and CRAR of 9.0%)*

Key rating drivers

Credit strengths

Sovereign ownership with demonstrated funding support – The GoI has majority shareholding in CBI with a stake of 86.40% as on June 30, 2018. During FY2018, the GoI infused equity capital of Rs. 5,158 crore in the bank to recoup the net loss of Rs. 5,105 crore during FY2018. With CBI's capital ratios being below the regulatory requirement as on June 30, 2018 and with losses expected during FY2019, regular equity infusion by the GoI is crucial from a near-term rating perspective.

Well-developed deposit franchise with strong CASA deposit base - The bank has a strong franchise with 4,685 branches and 4,886 ATMs as on March 31, 2018. This gives it access to a healthy and stable deposit base. The bank reported strong CASA of 42.46% as on March 31, 2018 (39.20% as on March 31, 2017 and 35.48% as on March 31, 2016), higher than the PSB average of 37% as on March 31, 2018. The increase in the CASA share was supported by the GoI's demonetisation exercise in Q3 FY2017 and the bank's stable credit book, reducing the need to raise bulk deposits.

Comfortable liquidity profile - ICRA expects CBI to maintain comfortable liquidity given the large proportion of retail deposits. The bank has flexibility to receive support from the RBI (through the repo and marginal standing facility mechanism) in case of urgent liquidity needs. CBI had comfortable liquidity coverage of 253.30% in Q4 FY2018 compared to the regulatory requirement of 90% from January 1, 2018.

Credit challenges

Weak asset quality – CBI reported gross and net NPAs of 22.17% and 10.58%, respectively, as on June 30, 2018 compared to 21.48% and 11.10%, respectively, as on March 31, 2018. CBI's gross and net NPA remained above the PSB average of 14.59% and 7.98%, respectively, as on March 31, 2018. CBI's solvency ratio worsened to 121% as on June 30, 2018 from 117% as on March 31, 2018 on higher slippages, and limited recovery and capital infusion. ICRA expects the vulnerable exposure to largely be recognised as NPAs by Q2 FY2019 and consequently, the bank's GNPAs are expected to peak. Thereafter, with the resolution of the stressed accounts, ICRA expects the GNPAs to start declining though they will remain elevated.

Capital adequacy ratios below regulatory levels, servicing debt capital instruments can be a challenge – On account of the continued losses being reported by the bank, its capitalisation profile has deteriorated significantly with CRAR, Tier I and CET I of 8.05, 6.05% and 6.05%, respectively, as on June 30, 2018 compared to 9.04%, 7.01% and 7.01%, respectively, as on March 31, 2018 and the regulatory requirement (including CCB of 1.875%) under Basel III of CRAR of 10.875%, 8.875% and 7.375% , respectively, for March 31, 2018.

As can be seen, the bank reported the capital adequacy below the regulatory Tier I and CRAR (excluding CCB) of 7.0% and 9.0% respectively as on June 30, 2018, which are critical to maintain for servicing its Basel II debt capital instruments. With expected continued losses, the bank would require additional equity support to meet the minimum capital requirements (7.00% Tier 1 and 9.00% CRAR) for servicing the coupon on Basel II instruments. As per ICRA's estimates, given the expected loss in FY2019, assuming a 15% reduction in RWA levels, CBI will require Tier I capital of ~Rs. 6,000-8,000 crore (33-44% of the market cap) to meet the regulatory capital requirements (including CCB and additional buffer of 50 bps) as on March 31, 2019. If the bank does not maintain the CCB but maintains a CET I/Tier I capital of 7.25-7.50%, the equity capital requirement is expected to be lower at Rs. 2,000-4,000 crore (11-22% of the market cap). The ability to raise sufficient capital in a timely manner will be critical for meeting the regulatory capital ratios and will be a key rating sensitivity.

Profitability expected to remain weak on elevated credit provisioning requirements – CBI's core profitability (after provisions) has been negative for the 11 quarters ending Q1 FY2019 with significantly high credit costs. With high NPAs and the consequent decline in earning assets, the bank's net interest margins (NIMs) were weak at 2.08% of average total assets (ATA) and 2.00% of ATA during Q1 FY2019 and FY2018, respectively. The core operating profit (before credit provisions and treasury gain/loss) was Rs. 454 crore (0.56% of ATA) and Rs. 2,385 crore (0.73% of ATA) for Q1 FY2019 and FY2018, respectively.

The bank's credit costs stood at Rs. 2,538 crore (3.15% of ATA) and Rs. 10,975 crore (3.36% of ATA) for Q1 FY2019 and FY2018, respectively, and far exceeded its core operating profits. The bank reported a net loss of Rs. 1,522 crore (1.89% of ATA) and Rs. 5,105 crore (1.56% of ATA) during Q1 FY2019 and FY2018, respectively. ICRA expects CBI's profitability to remain under pressure with increasing provisioning requirements and subdued operating profit due to de-growth of its advances.

Given the high level of net NPAs and continued losses, the bank was included under the prompt corrective action (PCA) framework of the RBI. Inclusion under the PCA framework constrains the bank's ability to expand and requires it to take corrective actions like capital raising and cost rationalisation to improve its profitability and capitalisation.

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 company

Mumbai-based Central Bank of India is a public sector bank with an 86.40% GoI ownership (as on June 30, 2018). The bank reported a loss after tax of Rs. 5,105 crore on a total asset base of Rs. 3.26 lakh crore in FY2018 compared to a loss after tax of Rs. 2,439 crore on a total asset base of Rs. 3.33 lakh crore in FY2017. During Q1 FY2019, the bank reported a loss after tax of Rs. 1,522 crore compared to a loss after tax of Rs. 577 crore during the corresponding period in the previous financial year. As on June 30, 2018, the bank reported capital adequacy under Basel III of 8.05% (Tier I: 6.05%), gross NPA of 22.17% and net NPA of 10.58%.

Key financial indicators - (standalone)

	FY2017	FY2018	Q1FY2018	Q1FY2019
Net interest income	6,574	6,517	1,331	1,678
Profit before tax	(3,529)	(7,896)	(818)	(2,385)
Profit after tax	(2,439)	(5,105)	(577)	(1,522)
Net advances	139,399	156,542	157,646	152,064
Total assets	333,402	326,225	329,653	325,086
% CET	8.62%	7.01%	7.47%	6.05%
% Tier I	8.62%	7.01%	7.47%	6.05%
% CRAR	10.95%	9.04%	9.61%	8.05%
% Net interest margin / Average total assets	2.08%	2.00%	1.62%	2.08%
% Net profit / Average total assets	(0.77%)	(1.56%)	(0.70%)	(1.89%)
% Return on net worth	(16.45%)	(34.50%)	(15.97%)	(43.20%)
% Gross NPAs	17.81%	21.48%	18.23%	22.17%
% Net NPAs	10.20%	11.10%	11.04%	10.58%
% Provision coverage excl. technical write offs	47.83%	54.43%	44.56%	58.52%
% Net NPA/ Net worth	96.48%	116.98%	122.94%	120.65%

Amount in Rs. crore
Source: CBI, ICRA research
All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sr. No.	Name of Instrument	Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	August 2018	May 2018	FY2018 Aug-17	FY2017 Mar-17	FY2016 Feb-16
1	Lower Tier II bonds programme	Long Term	500.00	500.00	[ICRA] A+ (negative)	[ICRA] A+ (negative)	[ICRA] A+ (negative)	[ICRA] A+ (negative)	[ICRA] AA- (negative)
2	Upper Tier II bonds programme	Long Term	285.00	285.00	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
3	Upper Tier II bonds programme	Long Term	500.00	500.00	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
4	Upper Tier II bonds programme	Long Term	500.00	500.00	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
5	Upper Tier II bonds programme	Long Term	1000.00	1000.00	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)

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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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating
INE483A09245	Lower Tier II bonds	21-Dec-2011	9.33% p.a.	21-Dec-2026	500.00	[ICRA]A+ (negative)
INE483A09195	Upper Tier II bonds	17-Feb-2009	9.40% p.a. Step up of 50 bps from 11th year (9.90% till maturity)	17-Feb-2024 With call option on 17-Feb-2019	285.00	[ICRA]A- &
INE483A09203	Upper Tier II bonds	23-June-2009	8.80% p.a. Step up of 50 bps from 11th year (9.30% till maturity)	23-June-2024 With call option on 23-June-2020	500.00	[ICRA]A- &
INE483A09211	Upper Tier II bonds	20-Jan-2010	8.63% p.a. Step up of 50 bps from 11th year (9.13% till maturity)	20-Jan-2025 With call option on 20-Jan-2020	500.00	[ICRA]A- &
INE483A09229	Upper Tier II bonds	11-June-2010	8.57% p.a. Step up of 50 bps from 11th year (9.07% till maturity)	11-June-2025 With call option on 11-June-2020	1,000.00	[ICRA]A- &

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Source: CBI

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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