ICRA

Bank of Baroda

November 29, 2018

Summary of Rated Instruments:

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds Programme	1,000.00	1,000.00	[ICRA]AAA(hyb)&; reaffirmed
Medium Term Fixed Deposit Programme	-	-	MAAA&; reaffirmed
Total	**1,000.00**	**1,000.00**	

&Under Rating Watch with Developing Implications
**Instrument details are provided in Annexure-1*

Rating action

ICRA has reaffirmed the [ICRA]AAA(hyb) (pronounced ICRA triple A hybrid) rating on the Rs. 1,000-crore Basel III compliant Tier II bonds programme and the rating of MAAA (pronounced M triple A) on the medium-term fixed deposits programme of Bank of Baroda (BOB)1. The rating continues to remain on rating watch with developing implications.

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 rated Tier II bonds are expected to absorb losses once the "point of non-viability" (PONV) trigger is invoked.

Rationale

The ratings reaffirmation considers moderation in fresh addition of non-performing assets (NPAs) for the bank during H1FY2019, which ICRA expects will continue during FY2019, leading to reduction in Net NPA (NNPAs) of BOB to 4.3-4.4% by March 2019. Reduced fresh slippages have resulted in improvement in profitability during H1FY2019, even though it continues to remain weak because of elevated provisioning levels. Further, the recent relaxation by Reserve Bank of India (RBI) for the scheduled increase in capital conservation buffer of 0.625% of risk weighted assets (RWAs) by one year to March 2020 will result in enough capital cushion over regulatory levels even in scenario of expected profitability. The ratings continue to remain supported by the majority sovereign ownership of the bank, demonstrated capital infusion by Government of India (GOI) into public sector banks (PSBs) including BOB, with capital infusion of Rs 5,375 crore in FY2018.

The ratings continue to be supported by BOB's strong franchise imparting healthy and stable deposits base and sound liquidity profile. BOB's domestic current account and saving account (CASA) deposits were 40.48% as on September 30, 2018 and high share of retail deposits which is a positive from cost of funds as well as liquidity perspective. ICRA further takes comfort from BOB's provision coverage of 62% as on September 30, 2018 being the highest in the industry (PSB average of ~53% as on September 30, 2018). High provision coverage is also expected to provide cushion to the net profitability as the stressed accounts undergo resolution. Though fresh slippages are expected to remain high in FY2019 these will be

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

lower than FY2018 and improved recoveries and upgrades is expected to support the overall asset quality numbers, provision coverage and solvency ratio, which are likely to improve vis-à-vis March 2018 levels.

The rating continues to remain on watch with developing implications because of the proposed merger of BOB, Vijaya Bank (rated [ICRA]AA+(hyb)& for Tier II bonds) and Dena Bank (Not Rated). The earning profile and the asset quality of the merged entity is expected to remain inferior to BOB, hence the internal capital generation is likely to remain weak in near term. Though ICRA expects BOB to not require equity capital to support its growth and maintain capital cushions in near term, however because of weak earnings and asset quality of Dena bank, the merged entity will require a sizeable capital infusion to maintain capital cushions in relation to rating levels. The merged entity in our view will also classify as domestic systemically important bank (D-SIB) after the merger, which will also need additional capital levels over the regulatory capital requirements and increase the overall capital requirement for the merged entity. Ability to maintain enough capital cushions (atleast 1% over regulatory levels[2] at CET-I and Tier-I level) by the merged entity will remain critical for the current rating levels. ICRA will continue to monitor the size of the capital infusion at the time of merger and the capital levels maintained by the merged entity. In case of weaker than expected capital levels, the rating may get downgraded.

Key rating drivers

Credit strengths

Sovereign ownership - The bank is majority owned by GoI with shareholding at 63.74% as on September 30, 2018. Upon the completion of proposed merger, the merged entity is also expected to remain majority owned by GOI, with expected GOI shareholding of ~66%. GoI has demonstrated capital infusion in all PSBs including BOB, whereby it infused equity capital of Rs. 5,735 crore during FY2018. ICRA expect the merged entity to require capital support to maintain capital cushions and for growth. The quantum and size of capital support from GOI will remain key driver for capital ratios and the rating level of the proposed merged entity.

Merger to create the second largest PSB in terms of total asset base and likely to be classified as domestic systemically important bank (D-SIB) – Based on asset base, BOB is the third largest PSB and the fifth largest bank with market share of 4.8% in the Indian banking sector. With the proposed merger, the merged entity will become the second largest PSB with estimated market share of 6.7% in total assets of the Indian banking sector. Consequently, ICRA expects that the merged entity is likely to be classified as D-SIB by the regulatory. The merged entity is expected to have a strong franchise supported by the second largest network of over 9,400 branches across India as on September 30, 2018.

Well-developed deposit franchise with adequate CASA deposit base - BOB has a well-developed deposit franchise resulting in a comfortable current account savings account (CASA) ratio of 40.48% for domestic operations and 35.33% for global operations as on September 30, 2018. This will however be offset by lower CASA deposit base of Vijaya Bank. The merged entity is expected to have a lower CASA base of ~33-34%, which will be slightly lower than ~37% level for PSBs.

Comfortable liquidity profile – BOB had SLR investment of Rs. 152,621 crore (30.24% of NDTL) much higher than regulatory requirements of 19.5% of NDTL as on September 30, 2018, which provides a liquidity cushion for the bank. ICRA expects BOB to maintain comfortable liquidity given its large proportion of retail deposits, access to call money markets and access to Repo and Marginal Standing Facility mechanism of RBI in case of urgent liquidity needs. The bank had a comfortable liquidity coverage ratio of 109.91% as on March 31, 2018 as against the regulatory requirement of 90% from January 1, 2018 and 100% as on January 01, 2019 onwards.

[2] Including additional capital buffer if classified as D-SIB

Credit challenges

Internal accruals to remain weak for merged entity – Supported by ~13% YoY growth in advances and lower interest reversals driven by reduced slippages, the NII for BOB increased 25% to Rs 8,874 crore during H1FY2019 (Rs 7,125 crore in H1FY2018), which also supported a 35% YoY growth in core operating profits[3] to Rs 5,896 crore (Rs 4,362 crore in H1FY2018) during this period. The credit provisions and other provisions (including mark to market provisions on bond portfolio) remain stable but elevated at Rs 4,595 crore (Rs 4,567 crore) that led to a strong YoY growth of 71% in net Profits. However, with return on assets of 0.26% (annualised) and return on net worth of 4.63% (annualised), the profitability of the bank remains weak during H1FY2019. Earlier during FY2018, driven by high credit provisions, the bank had reported a net loss of Rs 2,432 crore (Rs 1,383 crore net profit in FY2017). ICRA expects BOB to report profits during FY2019 with expected RoA of 0.1-0.4%.

For the merged entity, though the Vijaya Bank has reported profitable operations during H1FY2019 with net profit of Rs 284 crore during H1FY2019 but Dena Bank has reported net losses of Rs 1,138 crore during this period. Accordingly, Dena bank's losses have largely off-set the gains made by the other two banks resulting in a meagre net profit of Rs. 99 crore for the proposed merged entity during H1FY2019. For FY2019, depending on the credit provisions, ICRA expects the ROA of the merged entity to remain weak at -0.2% to 0.2%. Accordingly, the internal accruals for the merged entity are expected to remain weak and would lead to increased reliance on additional capital to maintain capital cushions over regulatory levels as well as support its growth requirements.

Sizeable capital infusion required for the merged entity to maintain capital cushions – The capitalisation levels for BOB remained satisfactory with CET1 of 9.05%, Tier 1 of 10.25% and CRAR of 11.88% as on September 30, 2018 as against regulatory requirement of 7.375%, 8.875% and 10.875% respectively as on March 31, 2019. Similarly, Vijaya Bank also reported satisfactory capital ratios with CET1 of 10.05%, Tier 1 of 11.36% and CRAR of 13.56% as on September 30, 2018. ICRA expects both these banks to not require equity capital during FY2019 to support their credit growth, though they may require the same in FY2020. On the contrary, the capital profile of Dena bank remained weak with CET1/Tier 1 of 7.63% and CRAR of 10.10% as on September 30, 2018. ICRA estimates the CET1 of 9.10%, Tier 1 of 10.13% and CRAR of 11.96% for the merged entity as on September 30, 2018.

Additionally, as highlighted earlier, the merged entity is likely to be classified as D-SIB, which will pose an additional CET requirement of 0.3-0.4% of RWA from FY2020 onwards. With expected ROA of -0.2% to 0.2% for merged entity, blended growth of 16-19% in risk weighted assets during FY2019, additional CET requirement, if classified as SIB, and cushion of at least 1% over regulatory levels to remain consistent with rating category, ICRA expects additional equity capital requirement of ~Rs. 5,500-6,000 crore during FY2019[4]. Given the impending merger, ICRA expects the merging entities to largely remain dependent on GoI for incremental capital requirements and the extent of capital infusion by GoI and resulting capital cushions will remain key rating driver for the merged entity.

Weak asset quality; credit costs to remain elevated - The asset quality for BOB deteriorated during FY2018, particularly in Q4 FY2018, after the discontinuance of all the earlier schemes for the resolution of stressed assets leading to their slipping into non-performing assets category. The overall slippages stood at Rs 24,239 crore (6% of standard advances), much higher than recovery, upgrades and write-offs during FY2018. Consequently, its gross and net NPAs increased to Rs 56,480 crore (12.26% of gross advances) and Rs 23,483 crore (5.49% of net advances, respectively, as on March 31, 2018 (GNPA of Rs 42,719 crore - 10.46% and NNPAs of Rs 18,080 crore - 4.72%, respectively, as on March 31, 2017). The slippages and moderated during H1FY2019 (GNPA addition of Rs 8,484 crore – 4.20% (annualised) of standard advances), which was lower than recovery, upgrades and write-offs leading to a reduction in GNPA and NNPAs to Rs 55,121 crore

[3] *Before treasury income/losses and credit provisions*

[4] Assuming a 1% buffer over regulatory capital levels

(11.79%) and Rs 21,059 crore (4.86%) respectively as on September 30, 2018. Provision coverage ratio (excluding write-offs) remains good at 62% for BOB in comparison to 52% for PSBs as on September 30, 2018. With elevated levels of Net NPAs, solvency ratio (Net NPAs/ Net worth) remains weak at 49.89% on September 30, 2018. As of September 30, 2018, BOB had a watchlist of accounts with exposure amounting to ~Rs. 8,500 crore (including SMA accounts and standard restructured accounts). Though slippages are expected to reduce to 3.8-4.5% of standard advances in FY2019 as compared FY2018, the slippages are still expected to remain elevated. Supported by recoveries, upgrades and write offs, ICRA expects the bank's Net NPAs to reduce with expected NNPA of 4.3-4.4% by March 2019. Notwithstanding the expected reduction in NNPAs, the credit cost is expected to remain elevated for the bank at 1.1-1.5% of ATA, which shall continue to translate in weak ROA of 0.1-0.4% during FY2019.

For the merged entity, driven by weak asset quality of Dena bank, the GNPAs are estimated to be lower than BOB at 11.85% but NNPAs are higher at 5.30% as on September 30, 2018, translating in a provision cover (without TWO) of 58.4%. The solvency level is also estimated to be weaker than BOB at 55%. With higher NNPAs, ICRA expects the credit provisions for the merged entity to remain elevated at 1.4-1.8% of ATA for FY2019, leading to a weak ROA of -0.2% to 0.2%. ICRA expects the merged entity to have weak asset quality with Net NPAs of 4.5%-4.6% as on March 31, 2019, and unless supported by large recoveries from NPAs, the credit provisions can remain elevated translating in moderate internal accruals even during FY2020, thereby requiring capital infusion to support growth.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks
Parent/Group Support	Government of India
Consolidation / Standalone	Rating is based on standalone financial statements of BOB and consolidated financials estimates of ICRA for the proposed merged entity.

About the company

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 63.74% stake in the bank as on September 30, 2018. The bank has a wide spread domestic network of 5,534 across India (as on September 30, 2018) and a large overseas presence. During H1FY2019, BoB reported a net profit of Rs. 954 crore on total assets of Rs.7.4 lakh crore as compared to a net loss of Rs. 2,432 crore on total assets of Rs.7.2 lakh crore during FY2018. The bank's Gross NPA% and Net NPA% stood at 11.79% and 4.86% respectively as on September 30, 2018 as against 12.27% and 5.49% respectively, as on March 31, 2018. The regulatory capital adequacy ratio stood at 11.88% as on September 30, 2018 (CET 1: 9.05% and Tier 1 of 10.25%).

Key financial indicators (audited) – Standalone

Instrument	FY2017	FY2018	Q2FY2018	Q2FY2019
Net Interest Income	13,513	15,522	3,721	4,493
Profit before tax	2,473	-2,791	712	652
Profit after tax	1,383	-2,432	355	425
Net advances	3,83,259	4,27,432	387,302	433,549
Total assets (adjusted for revaluation reserves)	6,91,299	7,16,843	673,375	638,409
% CET 1	8.98%	9.23%	8.39%	9.05%
% Tier 1	9.93%	10.46%	9.61%	10.25%
% CRAR	12.24%	12.13%	11.64%	11.88%
% Net interest margin / Average total assets	1.99%	2.20%	2.23%	2.48%
% Net profit/Average total assets	0.20%	-0.35%	0.21%	0.23%
% Return on net worth	3.80%	-6.32%	3.83%	4.10%
% Gross NPAs	10.46%	12.26%	11.16%	11.79%
% Net NPAs	4.72%	5.49%	5.05%	4.86%
% Provision coverage ratio excl. technical write offs	57.68%	58.42%	57.73%	61.79%
% Net NPA/ Net worth	49.23%	58.36%	52.49%	49.89%

Amounts in Rs. crore; All ratios are as per ICRA calculations

Source: BOB; ICRA research

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					
						FY2019		FY2018		FY2017	FY2016
		Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	Nov-18	Sep-18	Jun-18	Oct-17	Jun-17	Jul-16	Jul-15
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AAA (hyb) &	[ICRA]AAA (hyb) &	[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	NA	MAAA &	MAAA &	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)
4	Certificate of Deposit Programme	Short Term	-	-	-	-	-	-	[ICRA]A1+ withdrawn	[ICRA]A1+	[ICRA]A1+
5	Corporate Governance Rating	-	-	-	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2

&Under Rating Watch with Developing Implications

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 and Outlook
INE028A08059	Basel III Compliant Tier II Bonds Programme	17-Dec-2013	9.73%	17-Dec-2023	1,000	[ICRA]AAA(hyb) &
NA	Medium-term Deposits	-	-	-	-	MAAA &

Source: BOB

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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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