September 19, 2019

Canara Bank: Ratings placed on Watch with Developing Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds Programme	7,900.00	7,900.00	[ICRA]AA+ (hyb) &; Placed on rating Watch with Developing Implications
Additional Tier-I bonds programme – Basel III	1,500.00	1,500.00	[ICRA]AA- (hyb) &; Placed on rating Watch with Developing Implications
Total	**9,400.00**	**9,400.00**	

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

Syndicate Bank: Rating placed on Watch with Developing Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds Programme	3,250.00	3,250.00	[ICRA]AA (hyb) &; Placed on Watch with Developing Implications
Total	**3,250.00**	**3,250.00**	

& Denotes under rating Watch with Developing Implications
**Instrument details are provided in Annexure-2*

Rationale

On August 30, 2019, the Government of India (GoI) announced the merger of 10 public sector banks (PSBs) into four entities with a proposed capital infusion of Rs. 59,807 crore into 11 banks[1] and measures to improve the corporate governance standards in banks.

As a part of the announcement, the GoI proposed the merger of Canara Bank with Syndicate Bank, subject to the approval of the respective boards of the banks. Upon implementation, the merger is expected to create the fourth-largest PSB in India in terms of business (net advances and deposits) of Rs. 15.05 lakh crore (as on June 30, 2019) and the third-largest branch network in India with 10,342 branches as on June 30, 2019. The amalgamated entity (Canara-M) would have a large scale with a 7.1% share in net advances and a 7.2% share in total deposits as on June 30, 2019. Both banks use the same core banking solution (CBS) platform, iFlex, which, in the GoI's view, should result in better realisation of operational gains and provide an enhanced lending facility.

As a part of the merger process, the GoI announced a proposed capital infusion of Rs. 6,500 crore in Canara though no capital support was announced for Syndicate. While the capital allocation for Canara is largely in line with ICRA's

[1] GoI subsequently announced a capital infusion of Rs. 4,557 crore in IDBI Bank Limited ((rated [ICRA]A(Negative) for Tier II bonds)

estimates for FY2020, the merged entity will need to raise further Tier 1 capital to maintain a cushion over the regulatory levels given Syndicate's net non-performing assets (NNPAs) of 5.96% and solvency (NNPA/CET) of 85% as on June 30, 2019. Based on the merged financials of the banks, the NNPAs for the combined entity stood at 5.54% and solvency at 80% as of June 2019. The combined entity reported a net loss of Rs. 651 crore (return on assets – RoA of -0.26%) in Q1 FY2020.

In ICRA's view, for a 7-9% growth in risk-weighted assets (RWAs) and a 50-bps cushion over the regulatory capital requirements, the merged entity will need Rs. 3,200-5,500 crore of Tier 1 capital as its internal accruals are expected to remain weak with negative RoA of 0.2-0.3% in FY2020. If the merged entity maintains lower capital cushions or witnesses lower growth, the capital requirements may decline. Further, the merged entity has option to raise Tier 1 bonds or divest its non-core assets, which may lower the equity capital raising requirements. Given the merged entity's incremental capital requirement for maintaining a comfortable cushion over the regulatory ratios, ICRA will closely monitor the capital raising plans of the merging banks.

Additionally, the current account and savings account (CASA) profile of the merged entity will be much weaker than the PSB average, with the CASA share being ~30% of total deposits, given the low CASA share of both banks. This may translate into a higher cost of funds compared to peers and high reliance on bulk deposits for growth. Considering the significant increase in the scale of operations, the Reserve Bank of India (RBI) may classify Canara as a systemically important bank, which will increase its regulatory capital requirements.

The boards of both Canara and Syndicate have accorded in-principle approval to the merger, though it is still in a nascent stage. Given the initial stage of the proposed merger, ICRA has placed the ratings under Watch with Developing Implications and will take appropriate rating action as and when more clarity emerges on the capital position and solvency profile of the merged entity.

Key rating drivers and their description – NA

For the previous rationale of Canara – Click here

For the previous rationale of Syndicate - Click here

Liquidity position – Canara: Strong

Canara's liquidity profile remains **strong**, as reflected by the positive cumulative mismatches in the up to 1-year maturity bucket, as per its structural liquidity statement (SLS) dated February 28, 2019. Canara's liquidity coverage ratio (LCR) remained above the regulatory requirement at 108.84% (average for the quarter) as on June 30, 2019, thus aiding its liquidity profile. ICRA draws further comfort from the liquidity support available to the bank from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme), which can be availed in case of urgent liquidity needs.

Liquidity position - Syndicate: Strong

Supported by its established retail franchise in South India, which has aided its core deposit base, Syndicate's liquidity coverage ratio (LCR) remained above the regulatory requirement at 140.72% (average for the quarter) as on June 30, 2019. As per the structural liquidity statement as on June 30, 2019, the bank had a moderately negative cumulative mismatch of ~6.7% (as a percentage of total outflows) in the up to 1-year maturity bucket. ICRA expects Syndicate to maintain **strong** liquidity, given its steady core deposit base and sovereign ownership. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity needs. As on June 30, 2019, the bank was holding excess SLR investments of ~Rs. 6,615 crore (2.55% of total deposits).

Rating sensitivities

Positive triggers – ICRA could assign a Positive outlook and/or upgrade the ratings if the merged entity is able to reduce and maintain its NNPAs below 4% while improving its solvency (NNPA/CET) to <40% and maintaining a capital cushion of ~1% over the regulatory capital ratios on a consistent basis.

Negative triggers – ICRA could assign a Negative outlook and/or downgrade the ratings if the merged entity's NNPAs exceed 5% with a weak solvency profile of NNPA/CET of >60% on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Parent/Group Company: Sovereign ownership The ratings factor in Canara and Syndicate's sovereign ownership and demonstrated track record of capital infusion by the GoI
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of both Canara and Syndicate

About the company

Canara Bank

Canara is a large nationalised bank with the GoI owning a majority stake of 70.62% as on June 30, 2019. Headquartered in Bangalore, Canara has a pan-India presence, directly through a network of 6,323 branches and 8,837 ATMs, seven subsidiaries, an associate company and a joint venture.

The bank reported a profit after tax of Rs. 329 crore in Q1 FY2020 on a total asset base of Rs. 6.94 lakh crore as on June 30, 2019 against a profit after tax of Rs. 281 crore in Q1 FY2019 on a total asset base of Rs. 6.14 lakh crore as on June 30, 2018. Canara's gross and net NPAs stood at 8.77% and 5.35%, respectively, as on June 30, 2019. The bank reported a Tier I capital ratio of 8.91% and CRAR of 11.70% as on June 30, 2019.

Key financial indicators (audited) – Canara Bank

	FY2018	FY2019	Q1 FY2019	Q1 FY2020
Net interest income	12,163	14,478	3,883	3,241
Profit before tax	-6,561	-2,327	350	541
Profit after tax	-4,222	347	281	329
Net advances	3,81,703	4,27,727	3,86,253	4,32,768
Total assets	6,10,361	6,88,319	6,13,773	6,93,775
% CET 1	9.51%	8.31%	9.35%	8.20%
% Tier 1	10.30%	9.04%	10.12%	8.91%
% CRAR	13.22%	11.90%	13.00%	11.70%
% Net interest margin	2.05%	2.23%	2.54%	1.88%
% PAT / ATA	-0.71%	0.05%	0.18%	0.19%
% Return on net worth	-14.71%	1.18%	3.85%	4.40%
% Gross NPAs	11.84%	8.83%	11.05%	8.77%
% Net NPAs	7.48%	5.37%	6.91%	5.35%
% Provision coverage excl. technical write-offs	39.87%	41.48%	40.23%	41.24%
% Net NPA/ CET	85.3%	78.3%	79.6%	77.8%

Note: Amount in Rs. crore; Net worth and total assets exclude revaluation reserves
Source: Canara, ICRA research
All calculations are as per ICRA research

Syndicate Bank

Manipal (Karnataka)-based Syndicate Bank is a PSB that was established in 1925. The GoI held 78.48% in the bank as of June 30, 2019. As of June 30, 2019, the bank had about 4,011 branches, including a branch in London, and 4,345 ATMs. The bank's net worth (excluding revaluation reserves) stood at Rs. 14,088 crore as on June 30, 2019.

For Q1 FY2020, the bank reported a loss before tax of Rs. 1,159 crore on a total asset base (excluding revaluation reserves) of Rs. 3.03 lakh crore as on June 30, 2019 compared to a loss before tax of Rs. 1,768 crore in Q1 FY2019 on a total asset base (excluding revaluation reserves) of Rs. 3.04 lakh crore as on June 30, 2018. Syndicate's gross and net NPAs stood at 11.76% and 5.96%, respectively, as on June 30, 2019. The bank reported a Tier I capital ratio of 10.85% and CRAR of 13.70% as on June 30, 2019.

Key financial indicators (audited) – Syndicate Bank

	FY2018	FY2019	Q1 FY2019	Q1 FY2020
Net interest income	6,552	6,649	1,506	1,792
Profit before tax	-4,389	-3,103	-1,768	-1,159
Profit after tax	-3,223	-2,588	-1,282	-980
Net advances	2,10,684	2,05,044	1,95,899	2,02,782
Total assets	3,22,427	3,09,581	3,03,924	3,03,057
% CET 1	7.56%	9.31%	7.01%	8.85%
% Tier 1	9.41%	11.36%	9.00%	10.85%
% CRAR	12.24%	14.23%	11.84%	13.70%
% Net interest margin	2.11%	2.10%	1.92%	2.34%
% PAT / ATA	-1.04%	-0.82%	-1.64%	-1.28%
% Return on net worth	-24.74%	-18.00%	-40.21%	-26.62%
% Gross NPAs	11.54%	11.37%	12.59%	11.76%
% Net NPAs	6.28%	6.16%	6.64%	5.96%
% Provision coverage excl. technical write-offs	48.60%	48.83%	50.64%	52.42%
% Net NPA/ CET	95.6%	85.0%	108.6%	84.7%

Note: Amount in Rs. crore; Net worth and total assets exclude revaluation reserves
Source: Syndicate, ICRA research
All calculations are as per ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years – Canara Bank

	Instrument	Type	Amount Rated	Amount O/S	Rating (FY2020) Current Rating Sep-19-2019	Earlier Rating 11-Jul-2019	26-Apr-2019	Rating History for the Past 3 Years FY2019 29-Mar-2019	28-May-2018	11-May-2018	FY2018 05-Mar-2018	31-Jul-2017	FY2017 28-Dec-2016	01-Apr-2016
1	Tier-II Bonds – Basel III	LT	7,900	7,900	[ICRA]AA+ (hyb) &	[ICRA]AA+ (hyb) (Stable)	[ICRA]AA+ (hyb) (Stable)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)	[ICRA]AAA (hyb) (negative)
2	Additional Tier-I Bonds	LT	1,500	1,500	[ICRA]AA- (hyb) &	[ICRA]AA- (hyb) (Stable)	[ICRA]AA- (hyb) (Stable)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)	[ICRA]AA (hyb) (negative)
3	Certificates of Deposit	ST	-	-	-	[ICRA]A1+; Withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Lower Tier II Bonds	LT	-	-	-		[ICRA]AA+ (Stable); Withdrawn	[ICRA]AAA (negative)	[ICRA]AAA (negative)	[ICRA]AAA (negative)	[ICRA]AAA (negative)	[ICRA]AAA (negative)	[ICRA]AAA (negative)	[ICRA]AAA (negative)

& - Rating Watch with Developing Implications
Amount in Rs. crore

Rating history for past three years – Syndicate Bank

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018	FY2017
					19-Sep-2019	16-Aug-2018	28-May-2018	17-Aug-2017	28-Jun-2016
1	Basel III Compliant Tier II Bonds Programme	LT	3,250.00	2,900.00^	[ICRA]AA &	[ICRA]AA (hyb) (Negative)	[ICRA]AA+ (hyb) (Negative)	[ICRA] AA+ (hyb) (Negative)	[ICRA] AA+ (hyb) (Negative)

^ Rs. 350 crore yet to be placed
& Rating Watch with Developing Implications
Amount in Rs. Crore

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 – Canara Bank

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE476A08050	Tier-II Bonds - Basel III	27-Apr-16	8.40%	27-Apr-26	3,000	[ICRA]AA+ (hyb) &
INE476A08043	Tier-II Bonds - Basel III	7-Jan-16	8.40%	7-Jan-26	900	[ICRA]AA+ (hyb) &
NE476A09264	Tier-II Bonds - Basel III	31-Dec-15	8.40%	31-Dec-25	1,500	[ICRA]AA+ (hyb) &
INE476A09256	Tier-II Bonds - Basel III	27-Mar-14	9.70%	27-Mar-24	1,000	[ICRA]AA+ (hyb) &
INE476A09249	Tier-II Bonds - Basel III	3-Jan-14	9.73%	3-Jan-24	1,500	[ICRA]AA+ (hyb) &
INE476A08035	Additional Tier-I Bonds	5-Mar-15	9.55%	Perpetual	1,500	[ICRA]AA- (hyb) &

& – Rating Watch with Developing Implications

Source: Canara

Annexure-2: Instrument details – Syndicate Bank

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE667A08013	Tier-II Bonds - Basel III	02-Dec-2014	8.95%	02-Dec-2024	750.00	[ICRA]AA (hyb) &
INE667A08021	Tier-II Bonds - Basel III	23-Mar-2015	8.75%	23-Mar-2025	400.00	[ICRA]AA (hyb) &
INE667A08039	Tier-II Bonds - Basel III	28-Sep-2015	8.58%	28-Sep-2025	1,000.00	[ICRA]AA (hyb) &
INE667A08047	Tier-II Bonds - Basel III	18-Dec-2015	8.62%	18-Dec-2025	750.00	[ICRA]AA (hyb) &
-	Tier-II Bonds - Basel III	-	-	-	350.00#	[ICRA]AA (hyb) &

 # Yet to be issued

& Rating Watch with Developing Implications

Source: Syndicate

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