June 12, 2020

Bank of Baroda: Ratings reaffirmed

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Medium-term Fixed Deposit Programme	-	-	MAAA(Stable); reaffirmed
Basel III Compliant AT-I Bonds	500.00	-	[ICRA]AA(hyb)(Stable); reaffirmed and withdrawn
Basel III Compliant AT-I Bonds	825.00	825.00	[ICRA]AA(hyb)(Stable); reaffirmed
Basel III Compliant Tier II Bonds	2,450.00	2,450.00	[ICRA]AAA(hyb)(Stable); reaffirmed
Total	**3,775.00**	**3,275.00**	

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 bank's Basel III compliant Tier I bonds is two notches below the Basel III compliant Tier II bonds as these instruments have the following loss-absorption features that make them riskier:

• The coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel the coupon payments. The cancellation of discretionary payments shall not be an event of default.

• The coupons can be paid out of the current year's profits. However, if the current year's profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made from the reserves and surpluses created through the appropriation of profits (including statutory reserves). As per ICRA's estimates, these reserves and surpluses stood at ~2.85% of the risk-weighted assets (RWAs) for the merged entity as on December 31, 2019. 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 Reserve Bank of India (RBI) under Basel III regulations.

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 common equity Tier I (CET I) ratio, as prescribed by the RBI. The ratio is 5.5% before September 30, 2019 and 6.125% thereafter of the total RWAs of the bank or when the point of non-viability (PONV) trigger is breached, in the RBI's opinion.

Rationale

The ratings continue to be supported by the sovereign ownership and strong franchise of Bank of Baroda (BoB), imparting a healthy and stable deposit base and a sound liquidity profile. BoB is the second largest public sector bank (PSB) in terms of overall asset base and third largest in terms of the advances as on December 31, 2019. Given its importance, ICRA expects the bank to continue to receive support from the Government of India (GoI) in terms of required capital. The GoI infused additional capital of Rs. 7,000 crore in FY2020, which helped improve the capital ratios. BoB's domestic current account and savings account (CASA) deposits remained strong though marginally lower than the sector average, although it continues to operate with a competitive cost of funds and a granular term deposit base. This is a positive from a cost of funds as well as liquidity perspective.

Given the current economic slowdown and market disruptions caused by the Covid-19 pandemic, it is likely that that the bank's asset quality will be impacted with fresh NPA generation expected to remain elevated in FY2021. Slippages remained high in 9M FY2020 and kept the profitability weak. Though the GoI has not budgeted any capital for bank recapitalisation in FY2021, it has a demonstrated track record of capital infusion, including capital support prior to BoB's merger with Vijaya Bank and Dena Bank to help shore up the bank's capital ratios.

While the quantum of slippages will remain dependent on the extent of revival in economic activities and the mitigating measures taken to prevent wider asset quality challenges across sectors, ICRA expects fresh gross slippages at ~5-6% of standard advances in FY2021. This will likely translate into higher credit costs (estimated at 2.1-2.4% of average total assets; ATA), which are estimated to remain higher than the operating profitability. This will weigh on the internal capital generation. The credit costs are likely to decline in FY2022 if there is an improvement in the recovery environment though the same remains to be seen. Given the possibility of losses in FY2021 and a nominal growth of ~3-4% in RWAs, ICRA estimates the bank's overall equity capital requirement, in order to maintain capital cushions of at least 1% above the regulatory levels (including ~0.45% for domestic systemically important banks or D-SIBs), at ~Rs. 4,000-6,000 crore in FY2021. Furthermore, as per ICRA's estimates, the overall solvency profile could weaken from the current levels due to higher slippages unless supported by capital infusions. Hence, the amount of capital raise in FY2021 will remain a monitorable.

Key rating drivers and their description

Credit strengths

Sovereign ownership – The GoI remains the largest shareholder of BoB with a 71.60% equity stake in the bank as on December 31, 2019, which was higher than the pre-merger level of 63.26% as on March 31, 2019. The bank received capital support of Rs. 5,735 crore from the GoI in FY2018 and an additional Rs. 5,042 crore in March 2019 during the merger process, which helped maintain the capital position. As a part of its PSB recapitalisation programme in FY2020, the GoI infused further capital of Rs. 7,000 crore in BoB. Despite the weak profitability, the capital support from the GoI, coupled with the fresh Additional Tier I (AT-I) bond issuance of Rs. 2,897 crore (net of redemption of Rs. 500 crore), helped maintain the overall standalone capital ratios with CET I of 9.85%, Tier I of 11.45% and CRAR of 13.48% as on December 31, 2019. This was higher in comparison to 8.63%, 9.72% and 11.77%, respectively, as on April 1, 2019.

Second largest PSB in terms of total asset base – Prior to the merger with Vijaya Bank and Dena Bank, BoB was the third largest PSB, in terms of the asset base, and the fifth largest with a market share of 4.8% in the Indian banking sector. Following the merger, BoB is the second largest PSB with an estimated market share of 7.0% of the total assets in the Indian banking sector as on December 31, 2019. With an increase in size, ICRA expects that BoB could be classified as a D-SIB, which could require additional equity capital of ~0.45% of RWAs. Including the D-SIB capital requirements and the expected losses in FY2021, ICRA estimates the bank's Tier I capital requirement at Rs. 4,000-6,000 crore in FY2021, considering a cushion of 1% over the regulatory Tier I requirement. As discussed with management, BoB's subsidiaries largely remain self-sufficient in meeting their capital requirements in the near-to-medium-term and will require limited capital support from the bank. Given its importance, ICRA expects continued support from the GoI in terms of required capital.

Well-developed deposit franchise, leading to competitive cost of funds – Supported by its large branch network across India and a well-developed customer franchise, BoB holds a strong position with a ~7.1% market share in deposits as of December 31, 2019. The bank has a strong franchise, supported by the second largest branch network of 9,470 branches across India as on December 31, 2019. Further, the share of the top 20 depositors stood low at 3.2% of the total domestic deposits as on September 30, 2019.

However, despite a widespread deposit franchise, the domestic CASA deposit base remained marginally lower than the PSU average. Following the merger, the share of lower-cost CASA deposits moderated in comparison to the pre-merger levels due to the proportionately larger term deposit base of Vijaya Bank. However, BoB has witnessed a steady growth in CASA deposits, which increased the CASA deposit ratio to 38.84% as on December 31, 2019 from 37.26% as on April 1, 2019. The bank operates with a low cost of interest-bearing funds that stood at 4.93% in 9M FY2020 (partially supported by a sizeable overseas asset and deposit base) compared to the PSU average of ~5.03%. Going forward, ICRA expects the strong liability profile of BoB to remain a significant positive to support its credit growth while maintaining liquidity and profitability.

Credit challenges

Asset quality remains weak; asset quality stress likely to remain elevated due to Covid-19 – BoB's slippages remained high in 9M FY2020, with fresh GNPA addition of Rs. 25,703 crore or 5.46% (annualised) of standard advances. The bank witnessed high slippages from its exposure to non-banking financial companies (NBFCs) and a few chunky overseas exposures partly due to the forex impact. The extent of addition to the stock of GNPAs was contained due to sizeable recoveries, upgrades and write-offs of Rs. 22,488 crore during this period. This led to a less-steep increase in the GNPAs and NNPAs, with the same at Rs. 73,140 crore (10.43%) and Rs. 26,504 crore (4.05%), respectively, as on December 31, 2019 against Rs. 69,924 crore (10.02%) and Rs. 23,795 crore (3.65%), respectively, as on April 1, 2019. BoB's provision coverage ratio (excluding write-offs) stood at 64%, which remains in line with the PSBs' average of 63% as on December 31, 2019. The bank's SMA[1] 1 and SMA 2 stood at 3.60% of advances as on December 31, 2019 and remains a source of potential stress.

On a forward-looking basis, the bank is likely to continue to face asset quality related challenges in the near-to-medium-term because of the Covid-19 related lockdown and the quantum of slippages will remain dependent on the extent of revival in economic activities. In a scenario of expected slippages of ~5-6% of standard advances in FY2021 and a slower pace of recoveries and upgrades, ICRA expects the overall credit costs/ATA to remain high at ~2.1-2.4% in FY2021. With the NNPAs estimated at 4.0-4.2% as of March 2021, the credit provisions will remain elevated in the FY2022, translating into weak internal capital generation.

Elevated credit costs to keep internal accruals weak – On a merged basis, the YoY growth in advances remained weak at 2.7% with net advances of Rs. 6.54 lakh crore as on December 31, 2019 compared to Rs. 6.37 lakh crore as on December 31, 2018. Despite the slower growth, the net interest income (NII) grew by ~7% to Rs. 20,655 crore in 9M FY2020 from Rs. 19,276 crore in 9M FY2019 (BOB-S+ Vijaya+ Dena). This supported a ~6% growth in the operating profitability to Rs. 12,827 crore (Rs. 12,146 crore in 9M FY2019). However, driven by the high slippages to NPAs, the overall credit provisions remained higher than the operating profitability at Rs. 13,214 crore, which prevented a meaningful improvement in the bank's profitability and return metrics. Overall credit costs/ATA stood at 1.62% in 9M FY2020 against operating profit/ATA of 1.57%. While the trading gains reduced the impact of the high provisions, the same could not fully offset the impact, resulting in low return metrics with a net profit of Rs. 40 crore in 9M FY2020, translating into PAT/ATA (or RoA) of 0.01%. Going forward, with an estimated credit cost of 2.1-2.4% of ATA in FY2021, ICRA expects the bank's RoA to remain weak in FY2021.

Continued losses have been weakening BoB's distributable reserves (DRs) that could be used to service the coupon on the AT-I bonds in a year of losses. These reserves weakened to 2.85% of RWAs as on December 31, 2019 compared to 4.05% as on March 31, 2019 (pre-merger).

Solvency metrics likely to weaken from current levels in FY2021 – Though regular capital infusions improved the bank's capital ratios, the high slippages and increase in NNPAs prevented any meaningful improvement in the solvency levels (net NPAs/core equity). BoB's solvency level stood at 47% as on December 31, 2019, similar to the 48% level as on April 1, 2019 but marginally weaker in relation to the rating category of the bank. ICRA expects that the incremental asset quality related stress and weak profitability in FY2021 could exert pressure on the capital ratios as well as the solvency profile. Therefore, the extent of capital raise will remain a monitorable for these parameters.

---

[1] *SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as NPA as per the extant RBI guidelines*

Liquidity position: Strong

Supported by its strong retail liability franchise, the excess SLR holdings stood at >7% of the net demand and time liabilities as on December 31, 2019 while the bank had a comfortable liquidity coverage ratio of 124.56% as on December 31, 2019 against the regulatory requirement of 100% from January 1, 2019 onwards. ICRA expects BoB to maintain comfortable liquidity, given the large proportion of retail deposits and the high portfolio of liquid investments. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive triggers – Not applicable for the senior ratings. ICRA could upgrade the rating of the Tier I bond if there is an improvement in the profitability and capital cushions.

Negative triggers – The inability to improve the solvency profile to less than 40% will be a credit negative for the bank. ICRA expects strong support from the GoI, given the bank's systemic importance. Continued losses, which would result in further depletion of the DRs, would remain an additional trigger for the rating of the Tier I bond.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The ratings factor in BoB's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support BoB with capital infusions, if required.
Consolidation/Standalone	The ratings are based on the standalone financial statements of BoB. However, in line with ICRA's limited consolidation approach, the capital requirement of the Bank of Baroda group's key subsidiaries, going forward, has been factored in. In ICRA's view, BoB's subsidiaries are well capitalised and largely self-sufficient for their growth capital requirements and any capital infusion in the near-to-medium-term in the subsidiaries is expected to remain limited in relation to the bank's overall capital base.

About the company

Bank of Baroda was incorporated in 1908 and was nationalised in 1969, along with 13 other major commercial banks of India, by the Government of India. BoB is headquartered in Vadodara while its corporate office is in Mumbai.

On September 17, 2018, the GoI announced the merger of Vijaya Bank and Dena Bank with Bank of Baroda. The merger came into effect from April 01, 2019. As of December 31, 2019, the bank has 9,470 branches and 13,661 ATMs across India, of which ~57% are rural/semi-urban branches. It has an international presence spanning 100 overseas offices across 21 countries. Post-merger, BoB is now the second largest PSU bank in terms of the total asset base and third largest in terms of the advances base as on December 31, 2019.

Key financial indicators (audited) – Bank of Baroda

	FY2018 BoB-S	FY2019 BoB-S	9M FY2020 BoB-M
Net interest income	15,522	18,684	20,655
Profit before tax	-2,791	698	-79
Profit after tax	-2,432	433	40
Net advances	4,27,432	4,68,819	6,54,565
Total assets	7,20,000	7,80,987	10,92,155
% CET I	9.23%	10.38%	9.85%
% Tier I	10.46%	11.55%	11.45%
% CRAR	12.13%	13.42%	13.48%
% Net interest margin / Average total assets	2.20%	2.50%	2.53%
% Net profit / Average total assets	-0.35%	0.06%	0.00%
% Return on net worth	-6.32%	1.01%	0.08%
% Gross NPAs	12.26%	9.61%	10.43%
% Net NPAs	5.49%	3.33%	4.05%
% Provision coverage excl. technical write-offs	58.42%	67.64	63.76%
% Net NPA/ Net Worth	58.36%	34.14%	46.52%

Amount in Rs. crore

BoB-S pertains to the standalone financials prior to the merger and BoB-M pertains to the financials post-merger with Dena Bank and Vijaya Bank

Source: BoB, 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 (FY2021)				Chronology of Rating History for the Past 3 Years					
		Type	Rated Amount	Amount Outstanding	12 Jun 2020	FY2020 Apr 26, 2019	FY2019 Nov 29, 2018	Sep 28, 2018	Jun 11, 2018	FY2018 Oct 03, 2017	Jun 22, 2017
1	Basel III -Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AAA(hyb) (Stable); Reaffirmed	[ICRA]AAA(hyb) (Stable)	[ICRA]AAA (hyb)&	[ICRA]AAA (hyb)&	[ICRA]AAA (hyb) (Stable)	[ICRA]AAA (hyb) (Stable)	[ICRA]AAA (hyb) (Stable)
2	Term Deposits Programme	Long Term	NA	NA	MAAA(Stable); Reaffirmed	MAAA (Stable)	MAAA&	MAAA&	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)
5	Basel III -Tier II Bonds Programme (erstwhile Vijaya Bank)	Long Term	1,450	1,450	[ICRA]AAA(hyb) (Stable); Reaffirmed	[ICRA]AAA(hyb) (Stable) Assigned	-		-	-	-
6	Basel III AT I Bonds (erstwhile Vijaya Bank)	Long Term	500	-	[ICRA]AA(hyb) (Stable); Withdrawn	[ICRA]AA(hyb) (Stable) Assigned	-		-	-	-
7	Basel III AT I Bonds (erstwhile Vijaya Bank)	Long Term	825	825	[ICRA]AA(hyb) (Stable); Reaffirmed	[ICRA]AA(hyb) (Stable) Assigned	-		-	-	-
8.	Certificates of Deposit Programme	Short Term	-	-	-	-	-	-	-	-	[ICRA]A1+ withdrawn

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

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE705A08037	Tier II Bonds – Basel III	30-10-2014	9.15%	30-10-2024	500.00	[ICRA]AAA (hyb) (Stable); Reaffirmed
INE705A08052	Tier II Bonds – Basel III	18-02-2015	8.62%	18-02-2025	500.00	[ICRA]AAA (hyb) (Stable); Reaffirmed
INE705A08078	Tier II Bonds – Basel III	22-01-2016	8.64%	22-01-2026	450.00	[ICRA]AAA (hyb) (Stable); Reaffirmed
INE028A08059	Tier II Bonds – Basel III	17-12-2013	9.73%	17-12-2023	1,000	[ICRA]AAA (hyb)(Stable); Reaffirmed
INE705A08045	Additional Tier I Bonds – Basel III	02-02-2015	9.54%	-	100.00	[ICRA]AA (hyb) (Stable); Reaffirmed & Withdrawn
INE705A08060	Additional Tier I Bonds – Basel III	27-03-2015	10.40%	-	400.00	[ICRA]AA (hyb) (Stable); Reaffirmed & Withdrawn
INE705A08086	Additional Tier I Bonds – Basel III	03-03-2016	11.25%	-	500.00	[ICRA]AA (hyb) (Stable); Reaffirmed
INE705A08094	Additional Tier I Bonds – Basel III	17-01-2017	10.49%	-	325.00	[ICRA]AA (hyb) (Stable); Reaffirmed
NA	Medium-term Deposits	-	-	-	-	MAAA (Stable); Reaffirmed

Source: Bank of Baroda

Annexure-2: List of entities considered for limited consolidated analysis

Name	Ownership	Consolidation Approach
BOB Financial Solutions Limited	100.00%	Limited Consolidation
BOB Capital Markets Limited	100.00%	Limited Consolidation
Baroda Global Shared Services Limited	100.00%	Limited Consolidation
Baroda Sun Technologies Limited	100.00%	Limited Consolidation
Baroda Asset Management India Limited	100.00%	Limited Consolidation
Baroda Trustee India Private Limited	100.00%	Limited Consolidation
Nainital Bank	98.57%	Limited Consolidation
India First Life Insurance Company Limited	44.00%	Limited Consolidation
India Infradebt Limited	40.99%	Limited Consolidation
Baroda Uttar Pradesh Gramin Bank	35.00%	Limited Consolidation
Baroda Rajasthan Gramin Bank	35.00%	Limited Consolidation
Baroda Gujarat Gramin Bank	35.00%	Limited Consolidation
Bank of Baroda (Botswana) Limited	100.00%	Limited Consolidation
Bank of Baroda (Kenya) Limited	86.70%	Limited Consolidation
Bank of Baroda (Uganda) Limited	80.00%	Limited Consolidation
Bank of Baroda (Guyana) Limited	100.00%	Limited Consolidation
Bank of Baroda (New Zealand) Limited	100.00%	Limited Consolidation

Bank of Baroda (Tanzania) Limited	100.00%	Limited Consolidation
Bank of Baroda (Trinidad & Tobago) Limited	100.00%	Limited Consolidation
Bank of Baroda (UK) Limited	100.00%	Limited Consolidation
Bank of Baroda (Ghana) Limited	100.00%	Limited Consolidation
India International Bank (Malaysia), Berhad	40.00%	Limited Consolidation
Indo-Zambia Bank Limited	20.00%	Limited Consolidation
Bank of Baroda (UK) Limited	100.00%	Limited Consolidation

Source: BoB & ICRA research

Analyst Contacts

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Samiksha Karnavat
+91 22 6114 3471
samiksha.karnavat@icraindia.com

Aashay Choksey
+91 22 6114 3430
aashay.choksey@icraindia.com

Relationship Contact

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents