September 14, 2020

Bank of Maharashtra: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel II Lower Tier II Bonds	1,000.00	1,000.00	[ICRA]A+ (Positive); Reaffirmed
Basel II Upper Tier II Bonds	400.00	0.00	[ICRA]A (Positive); Reaffirmed and withdrawn
Basel II Tier I bonds	70.00	0.00	[ICRA]A (Positive); Reaffirmed and withdrawn
Basel III Tier II Bonds	1,600.00	1,600.00	[ICRA]A+ (hyb) (Positive); Reaffirmed
Total	**3,070.00**	**2,600.00**	

**Instrument details are provided in Annexure-1*

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 under Basel III are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

Rationale

The rating reaffirmation considers the majority sovereign ownership of Bank of Maharashtra (BoM) and the above-average resource profile, supported by an established retail network with a strong presence in Maharashtra. Moreover, the steady resource profile aids healthy traction in low-cost current account and savings account (CASA) deposits, which translates into a granular deposit base and low cost of funds. The bank continued to witness an improvement in its financial profile, solvency and capital position in Q4 FY2020 and Q1 FY2021, in line with ICRA's expectations.

ICRA expects that the Covid-19 pandemic, which has induced stress on economic growth, will impact the asset quality of the banking sector, including BoM. As on June 30, 2020, a high proportion of BoM's loan book was under moratorium, amounting to ~23% of the eligible borrowers or ~20% of the overall loan book in value terms. While this is estimated to have declined in August 2020, it will continue to pose uncertainty regarding the asset quality, earnings, and capital position in the near term. Although this could result in high slippages, loan restructuring and higher provisioning requirements, ICRA expects the bank to be well placed to absorb a large portion of the incremental credit provisions through its operating profits, given the high provision coverage ratio (PCR) of 85.62%[1] on the existing stressed assets and the decline in the net NPAs to 4.1% as on June 30, 2020. This will, however, lead to muted profitability and the need for growth capital.

In ICRA's view, for a growth of 8-10% in the risk-weighted assets (RWAs) and a cushion of 75 bps over the regulatory capital requirements, the bank needs to be well placed on its core capital (CET-I). However, there could be a

[1] *Including technical write-offs (TWO)*

moderation in the Tier I capital cushion over the regulatory requirement of 9.5% (including capital conservation buffer - CCB). As per ICRA's estimates, BoM's capital requirements are modest and manageable at ~Rs. 400-800 crore of the Tier I capital in the near term.

ICRA expects that BoM will continue to benefit from its sovereign ownership and strong resource profile. While near-term stress could emerge on the asset quality because of the pandemic, this is expected to be absorbed through its operating profits. Moreover, the capital requirements will remain manageable, driving the Positive outlook on the ratings.

ICRA has withdrawn the rating assigned to the Rs. 400-crore Basel II Upper Tier II Bonds and Rs.70 crore Basel II Tier I bonds as these bonds are fully redeemed, and no amount is outstanding against the rated instruments. The rating was withdrawn in accordance with ICRA's policy on withdrawal and suspension (click here for the Policy)

Key rating drivers and their description

Credit Strengths

Sovereign ownership – BoM has a majority sovereign ownership with the Government of India (GoI) holding an equity stake of 93.33% as on August 31, 2020. The bank has received regular capital support from the GoI in the past with infusions of Rs. 9,007 crore during FY2017-FY2020 (including Rs. 831 crore in FY2020). This helped the bank provide adequately against stressed assets, while improving its capital ratios above the regulatory levels, and exit the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework in January 2019. In ICRA's view, while the bank has sufficient capital cushions at the core capital (CET) level, it will need to shore up its capital position at the Tier I level. The GoI has not budgeted any capital infusion for public sector banks (PSBs) in FY2021. Hence, BoM's ability to raise equity capital from market sources remains a monitorable.

Above-average resource profile with strong CASA share – BoM has an established retail franchise with a strong regional presence in Maharashtra, depicted by its network of 1,833 branches (~61% located in Maharashtra) as on June 30, 2020. This has supported a healthy resource profile with the bank being able to maintain a steady deposit base. BoM's low-cost CASA deposits grew 13.5% YoY to Rs. 75,842 crore as on June 30, 2020 and accounted for 49.6% of the total deposit base, which is much higher than the CASA share of PSBs. BoM maintained a granular deposit base with the top 20 depositors accounting for ~4.5% of the total deposits as of June 30, 2020, which is also better than the PSBs' average. Supported by the granular deposit base with a high CASA share, BoM's cost of interest-bearing funds remained very competitive at 4.53% in Q1 FY2021 and 4.74% in FY2020 and was better than the industry average.

Credit challenges

Increased uncertainty on asset quality, given Covid-19-induced moratorium on loan book – As on June 30, 2020, a high proportion of BoM's loan book was under moratorium, amounting to ~23% of the eligible borrowers or ~20% of the overall loan book in value terms. While this is estimated to have declined in August 2020, it has created uncertainty regarding the asset quality, earnings, and capital position in the near term. While the RBI has permitted the restructuring of loans, which could reduce slippages in the near term, the bank's SMA 1 and SMA 2[2] books stood at 2.57% and 0.85%, respectively, of standard advances (total 3.42%) as on March 31, 2020 and are unlikely be restructured. As per ICRA's recent report, around 5-8% of advances in the banking sector could get restructured, which could also result in a high level of loan restructuring for BoM. While the restructuring can moderate the gross fresh slippages from the level of 5.3% witnessed in FY2020, the uncertainty regarding the asset quality has increased given the weaker economic conditions.

On the positive side, the bank has provided significantly for its stressed assets and the PCR on the existing stressed assets is high at 85.62%[3] while the net NPAs stood at a multi-year low of 4.1% as on June 30, 2020.

Weak earnings profile; likely to continue in FY2021 – Unlike its previous expectations of an improvement in the earnings profile, ICRA now expects that the earnings could remain under pressure because of a rise in the stressed assets and a consequent increase in the credit costs. However, on the positive side, the high provision cover on the existing stressed assets could enable the bank to absorb the asset quality shocks through its operating profits without a major impact on the existing capital position. ICRA expects BoM's return on assets (RoA) to remain <0.1% in FY2021, as against the bank's guidance of ~0.3-0.4%. Nevertheless, ICRA expects the bank's RoA to improve thereafter. With weak internal capital generation, the bank will need to raise growth capital or capital for absorbing the asset quality shocks if they turn out to be higher than ICRA's estimates.

Overall, the bank's earnings profile is supported by its competitive cost of funds, leading to slightly better net interest margins (NIMs) compared to the PSBs' average. This is despite the much lower credit-to-deposit ratio and the dragging effect of excess liquidity on NIMs. However, lower non-interest income and marginally higher operating costs led to the operating profitability being similar to the PSBs' average. Supported by a capital infusion of Rs. 7,876 crore from the GoI in FY2018 and FY2019, the bank made accelerated provisions on its stressed assets in FY2019 to exit the PCA framework by reducing its net NPAs to <6%. This resulted in a sharp decline in BoM's losses before tax in FY2020 and it posted a marginal profit in Q1 FY2021.

Modest capitalisation profile – BoM's capital metrics remained modest with CET-I%/Tier I% and CRAR% of 10.23% and 13.21%, respectively, as on June 30, 2020[4]. While the capital cushion remains comfortable at the core capital level, it is modest at the Tier I level. With expectations of a weak earnings outlook, the bank may need to raise capital to maintain the Tier I capital cushions for growth as well as to absorb any unforeseen asset quality stress.

BoM was among the PSBs that had exercised an early call option on their additional tier I (AT-I) bonds, given the deteriorating profitability and weak capital position. With sizeable losses during the last four years, the bank has

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[2] *SMA stands for special mention account and is bucketed into three categories - SMA0 (overdue by 1-30 days), SMA1 (overdue by 31- 60 days) and SMA2 (overdue by 61-90 days)*

[3] *Including technical write-offs (TWO)*

[4] *Minimum regulatory CET-I, Tier I and CRAR stood at 7.375%, 8.875% and 10.875%, respectively, as on March 31, 2019; with the CCB increasing to 2.50% from 1.875% effective September 30, 2020, the regulatory CET-I, Tier I and CRAR requirements will be 8.0%, 9.5% and 11.5%, respectively, as on September 30, 2020*

completely eroded its distributable reserves (DRs), which can be used to service AT-I bonds in a year of loss. BoM has now proposed to set off its accumulated losses against the share premium account, which could increase the size of the DRs and improve its ability to service the AT-I bonds. However, this is subject to regulatory approvals. In the absence of approvals, the ability to raise Tier I debt capital will be limited and the bank will need to raise equity capital to shore up the Tier I capital position. BoM's board has approved a capital raising of Rs. 2,000 crore, though the capital requirements are likely to be lower in ICRA's view.

In ICRA's view, for a growth of 8-10% in the risk-weighted assets (RWAs) and a cushion of 75 bps over the regulatory capital requirements, the bank needs to be well placed on its core capital (CET-I). However, there could be a moderation in the Tier I capital cushion over the regulatory requirement of 9.5% (including capital conservation buffer - CCB). As per ICRA's estimates, BoM's capital requirements are modest and manageable at ~Rs. 400-800 crore of the Tier I capital in the near term.

Despite reporting losses before tax in FY2020, BoM's core capital improved because of the capital infusion of Rs. 831 crore in Q4 FY2020. This, coupled with the lower net NPAs, resulted in an improvement in the bank's solvency profile to 50% by March 31, 2020 and 44% as on June 30, 2020 compared to 64% as on March 31, 2019. While the capital position and the solvency position are better than the positive rating triggers, BoM's ability to maintain/improve these remains a monitorable given the expectations of asset quality pressure.

Liquidity position – Superior

The bank has a low credit-to-deposit ratio (~59% as on June 30, 2020 vs ~66-68% for PSBs), driving excess liquidity that has been deployed in Government securities. As a result, it has been maintaining excess SLR holdings with a fortnightly average surplus of Rs. 16,000 crore (~11% of average net demand and time liabilities) during January-July 2020. This has, in turn, supported BoM's strong liquidity coverage ratio (LCR), which stood at 232% for Q1 FY2021. As per the structural liquidity statement (SLS), as on June 30, 2020, the bank had a negative cumulative mismatch of ~5.9% (of total outflows) in the up to 1-year bucket. ICRA expects BoM's retail liability franchise to support its deposit rollover and liquidity.

Rating sensitivities

Positive triggers – ICRA could upgrade the ratings if BoM is able to improve its solvency profile, with net NPA/core equity of less than 60%, while maintaining capital cushions of ~50-75bps over the regulatory Tier I level (including CCBs) on a sustained basis.

Negative triggers – The rating outlook could be revised to Stable or the ratings could be downgraded if there is a change in the majority sovereign ownership of the bank. Additionally, the ratings could be downgraded if BoM does not maintain the capital ratios above the regulatory level (including CCBs) or if the net NPAs exceed 6.0% on a sustained basis. The weakening of the solvency profile with net NPA/core equity exceeding 65-70% on a sustained basis will also be a negative trigger.

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 BoM's sovereign ownership and the demonstrated track record of capital infusion by the GoI
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of BoM

About the company

The bank was registered in 1935 in Pune (Maharashtra) as a public limited company, named The Bank of Maharashtra Ltd., with the objective of assisting small business enterprises, traders and self-employed individuals. Subsequently, with an increasing scale of operations, it became a scheduled bank in 1944 and acquired four small banks (Bank of Konkan Ltd., Bank of Nagpur Ltd., Bharat Industrial Bank Ltd. and Banthia Bank Ltd.) to expand its operations. BoM was nationalised, along with 13 other banks, in July 1969.

As on June 30, 2020, BoM had a wide network of 1,833 branches largely spread across Maharashtra. In FY2020, the bank reported a net profit of Rs. 389 crore (RoA of 0.24%) on a total asset base of Rs. 1.68 lakh crore as on March 31, 2020 compared to a net loss of Rs. 4,784 crore in FY2019 on a total asset base of Rs. 1.63 lakh crore as on March 31, 2019.

Key financial indicators – Bank of Maharashtra

	FY2019	FY2020	Q1 FY2020^	Q1 FY2021^
Net interest income	3,733	4,279	997	1,088
Profit before tax	-5,129	-260	-262	101
Profit after tax	-4,784	389	81	101
Net advances	82,666	86,872	81,205	89,740
Total assets (Rs. lakh crore)	1.63	1.68	1.54	1.80
% CET-I	9.88%	10.67%	9.68%	10.23%
% Tier I	9.91%	10.67%	9.71%	10.23%
% CRAR	11.86%	13.52%	11.69%	13.21%
% Net interest margin	2.35%	2.59%	2.51%	2.50%
% PAT/ATA	-3.01%	0.24%	0.20%	0.23%
% Return on net worth	-54.68%	4.28%	3.65%	4.24%
% Gross NPAs	16.40%	12.81%	17.90%	10.93%
% Net NPAs	5.52%	4.77%	5.98%	4.10%
% Provision coverage excl. technical write-offs	70.25%	62.00%	70.83%	65.18%
% Net NPA/Core capital	63.97%	49.96%	69.27%	44.33%

Note: Amount in Rs. crore; Net worth and total assets exclude revaluation reserves

^ Quarterly results are unaudited; Profitability ratios are annualised for the quarter

Source: BoM, 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

	Instrument	Type	Current Rating (FY2021) Amount Rated	Amount Outstanding	14-Sep-2020	Rating History for the Past 3 Years FY2020 26 Feb 2020	FY2019 13-Mar-2019	FY2019 27-July 2018	FY2018 19-Apr 2018	FY2018 10-Aug 2017	FY2018 28-Jun 2017
1	Basel II Lower Tier II Bonds	Long Term	1,000	1,000	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)
2	Basel II Lower Tier II Bonds	Long Term	130	0	-	[ICRA]A+(Positive); Withdrawn	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)
3	Basel II Upper Tier II Bonds	Long Term	400	0	[ICRA]A (Positive) Withdrawn	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
4	Basel II Tier I Bonds	Long Term	70	70	[ICRA]A (Positive) Withdrawn	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
5	Basel III Tier II Bonds	Long Term	1,600	1,100#	[ICRA]A+(hyb) (Positive)	[ICRA]A+(hyb) (Positive); Assigned	[ICRA]A+(hyb) (Stable)	[ICRA]A+(hyb) (Negative)	[ICRA]AA- (hyb) (Negative)	[ICRA]AA- (hyb) (Negative)	[ICRA]AA- (hyb) (Negative)

Amount in Rs. crore; # Balance yet to be placed

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
INE457A08050	Basel III - Tier II Bonds	6-Mar-2020	8.70%	6-Mar-2030	600.00	[ICRA]A+ (hyb) (Positive)
INE457A09199	Basel II - Lower Tier II Bonds	31-Dec-2012	9.00%	31-Dec-2022	1,000.00	[ICRA]A+(Positive)
INE457A09157	Basel II - Upper Tier II Bonds	30-Sep-2009	8.95%	30-Sep-2024	100.00	[ICRA]A (Positive); Withdrawn
INE457A09173	Basel II - Upper Tier II Bonds	01-Feb-2010	8.65%	01-Feb-2025	300.00	[ICRA]A (Positive); Withdrawn
INE457A09165	Basel II – Tier I Bonds	30-Sep-2009	9.25%	Perpetual	70.00	[ICRA]A (Positive); Withdrawn
INE457A08035	Basel III - Tier II Bonds	27-Jun-2016	9.20%	27-Sep-2026	500.00	[ICRA]A+ (hyb) (Positive)
-	Basel III - Tier II Bonds	-	-	-	500.00^	[ICRA]A+ (hyb)(Positive)

^Yet to be issued

Source: BoM

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