Vijaya Bank

Instruments	Amount (Rs. Crore)[1]	Rating Action (September 2016)
Additional Tier-I Bonds Programme-Basel III	750.00	[ICRA]AA- (hyb) (negative); assigned
Additional Tier-I Bonds Programme-Basel III	1,000.00	[ICRA]AA- (hyb) (negative); reaffirmed
Tier-II Bonds Programme-Basel III	1,500.00	[ICRA]AA+ (hyb) (negative); reaffirmed

ICRA has assigned a [ICRA]AA-(hyb) (pronounced ICRA double A minus hybrid) rating with a negative outlook to the Rs. 750.00 crore Basel III compliant additional tier-1 bond programme of Vijaya Bank ("VB")[2]**.** ICRA has also reaffirmed the [ICRA]AA- (hyb) rating for the Rs.1,000.00 crore Basel III compliant additional tier-1 bond programme and the [ICRA]AA+(hyb) (pronounced ICRA double A plus hybrid) rating for the Rs.1,500.00 crore Basel-III compliant tier-II bond programmes of VB. The outlook on the ratings is negative.

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 Basel III compliant tier I bonds is two notches lower than the Basel III complaint tier II bonds as these instruments have the following loss absorption features that make them riskier:

- The bank has full discretion at all times to cancel the distribution or payments and cancellation shall not be an event of default
- The minimum capital conservation ratio applicable to commercial banks may restrict the bank from servicing these tier I bonds in case the common equity tier-I falls below the limit prescribed by the RBI

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 ratio as prescribed by the RBI. The ratio is 5.5% till March 2019 and thereafter 6.125% of the total risk weighted assets of the bank or when the point of non-viability" (PONV) trigger is breached in the RBI's opinion.

The rating action factors in the bank's sovereign ownership (70% stake held by the Government of India as on June 30, 2016), its strong retail franchise, comfortable capitalisation profile (tier-I capital at 9.5% as on June 30, 2016) and comfortable liquidity profile (liquidity coverage ratio at 121% as on March 31, 2016). The ratings takes into account the bank's weakening asset quality with gross NPAs increasing from 4.3% as on December 31, 2015 (4.0% as on September 30, 2015) to 7.3% as on June 30, 2016, and solvency[3] weakening from 42% as on December 31, 2015 (38% as on September 30, 2015) to 69% as on June 30, 2016. The consequent increase in the bank's credit costs[4] from 0.6% in FY2015 to 1.0% in FY2016 has resulted in a moderation in its pre-tax profitability (PBT/ATA) from 0.4% in FY2015 to 0.1% in FY2016. During Q1FY2017, despite the credit cost remaining high at 0.7%, an improvement in net interest margin with a reduction in cost of funds has resulted in the pre-tax profitability improving marginally to 0.5% (annualized). ICRA notes that the bank's non-interest income[5] as a proportion of average total assets have historically remained low at around 0.4-0.5% compared to public sector bank average of 0.8-1.2%.

ICRA estimates that the share of bank's standard restructured assets and other vulnerable assets in gross advances stood at 2.2% and 2.0% respectively as on June 30, 2016, indicating likely incremental pressure on its asset quality going forward. The bank's ability to control incremental slippages, undertake effective recoveries and control incremental credit costs would remain the rating sensitivities going forward.

The bank has a comfortable capitalization profile with tier-1 capital at 9.5% (CET-1 at 8.3%) as on June 30, 2016, as against the minimum regulatory tier-1 capital requirement of 9.5% (CET-1 of 8.0%) by March 2019[6].

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[1] Rs. 1 crore = Rs. 10 million = Rs. 100 lakh
[2] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications
[3] Net NPA / net-worth excluding revaluation reserve
[4] Credit provisions / average total assets
[5] Excluding trading profits
[6] Including capital conservation buffer

As per ICRA's estimate, the bank's incremental total tier-1 capital requirement till FY2019 is moderate at 0.7-1.1 times[7] its current market capitalization. ICRA notes that the bank has not received any capital from the government so far in the current fiscal (Rs. 220 crore received during FY2016).

During the 12-month period ending June 30, 2016, the bank's gross advances grew by 6%, driven by a healthy growth in the retail and MSME segments by 30% and 37% respectively. The growth is in-line with the banking sector's focus on increasing the share of relatively less vulnerable and better yielding non-corporate segments. During the same period, the bank's total deposits grew by 6%, with some improvement in the deposit profile as indicated by the share of CASA deposits improving from 20.2% to 21.9% and the share of high cost bulk term deposits moderating from 34.2% to 32.9%.

Bank Profile
Vijaya Bank (VB) is a mid-sized commercial bank with a majority stake holding by the Government of India (70% as on June 30, 2016). Headquartered in Bangalore, VB has a strong presence in South India. The bank had an asset base of about Rs. 1.45 lakh crore (adjusting for revaluation reserves) and a network of 1,868 branches and 1,680 ATMs as on June 30, 2016.

Recent Results
During FY2016, VB reported a net profit of Rs. 382 crore on a total asset base of Rs. 1.45 lakh crore as against a net profit of Rs. 439 crore on a total asset base of Rs. 1.42 lakh crore in FY2015. In Q1FY2017, the bank reported a net profit of Rs. 162 crore (Rs. 143 crore for Q1FY2016).

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[7] Assuming a buffer of 1.0% over and above the regulatory minimum requirement and an annualized growth of 12-15% in risk weighted assets and internal generation (net of dividends) of 7-11% during FY2017-FY2019

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