

Canara Bank

Instruments	Amount (Rs. crore ¹)	Rating Action
Tier-II Bonds Programme – Basel III	3,000	[ICRA]AAA (hyb) (negative); assigned

ICRA has assigned the rating of [ICRA]AAA(hyb) (pronounced ICRA triple A hybrid) with negative outlook to the Rs. 3,000 crore fresh Basel-III compliant Tier-II bond programmes of Canara bank (“Canara” / “the bank”). The bank already has rating outstanding of [ICRA]AAA (hyb) with negative outlook for the Rs. 4,900 crore Basel-III compliant Tier-II bond programmes.

ICRA also has long-term rating of [ICRA]AAA (pronounced ICRA triple A) outstanding on the Rs. 2,000 crore Lower Tier-II bonds and the [ICRA]AA (hyb) (pronounced ICRA double A hybrid) rating outstanding on the Rs. 1,500 crore Basel-III compliant Additional Tier-I bonds of the bank. ICRA also has short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) outstanding on the Rs. 50,000 crore Certificate of Deposits programme of the bank. The outlook on the long-term rating 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.

Furthermore, the rating for the Basel III compliant Tier I bonds is two notches lower than the Basel III complaint Tier II bonds of the bank as these instruments have the following loss absorption features that make them riskier.

- Bank has full discretion at all times to cancel distribution/payments and cancellation of discretionary payments shall not be an event of default.
- The minimum capital conservation ratio applicable to the banks may restrict the bank from servicing these Tier I bonds in case the Common Equity Tier-I falls below limit as prescribed by RBI.

These Tier I bonds are expected to absorb losses through Write-Down Mechanism at the Objective Pre-Specified Trigger Point fixed at Bank's Common Equity Tier-I ratio as prescribed by RBI, 5.5% till March 2019 and thereafter 6.125% of Total Risk Weighted Assets of the Bank or when the “Point of Non Viability” (PONV) trigger is breached in the RBI's opinion.

The assigned rating factors in the majority ownership by Government of India (66.30% as of Dec-15) ensuring sovereign support, established franchise network imparting healthy and stable deposit base and the bank's comfortable overall liquidity profile. The rating also considers the deterioration in the bank's asset quality indicators (gross NPA at 5.8% as of December 15) and profitability indicators (ROAA at 0.3% for 9m FY2016) during the current fiscal post the RBI's 'Asset Quality Review' (AQR) in Q3FY2016. In the bank's fresh slippage of Rs. 5,402 crore during Q3FY2016, around 60% (around Rs. 3,300 crore) was on account of AQR and the same quantum of slippages due to AQR is expected to be recognised in Q4FY2016, which is expected to keep the Gross NPA % of the bank at elevated levels in the medium term. The bank has a sizeable share of the standard restructured advance at around 6.1% in December 2015 and its NPA provision cover² was modest at 35%, resulting in net NPA of 3.9% as of December 2015. Consequently, the bank's solvency³ stood modest at 43% as of December 2015. ICRA takes note of the higher than anticipated stress and slower than expected pace of recovery and weak outlook for several credit intensive sectors; this is likely to keep the fresh NPA generation rate at elevated levels and make recoveries more challenging over the next 1-2 years. The rating takes cognisance of the bank's exposure to power and iron & steel sector at 14% and 4% of the total advances respectively. While the bank's overall asset quality metrics presently compares well vis a vis most peer public sector banks, ability to control incremental slippages within reasonable levels would be critical from a rating perspective.

1 Rs. 1 crore = Rs. 10 million = Rs. 100 Lakh

2 (Gross NPA-Net NPA)/Gross NPA

3 Net NPA as a proportion of net worth

For 9m, FY2016, the bank's profitability profile was moderate, characterized by return on average assets (ROAA) of 0.3% (0.5% in 9m, FY2015) and return on equity (ROE) of 5.2% (11.1% in 9m, FY2015). Anticipated higher credit costs over next 2-3 years is likely to exert pressure on earnings and therefore internal capital generation. Furthermore, requirement to increase provisioning cover for some restructured advances could increase the credit cost further in FY2017. ICRA takes note of the bank's exposure to state power discoms was at around 5-6% of the total gross credit. Post implementation of the UDAY⁴ scheme, a portion of these discom exposures would get converted to bonds and could negatively impact the bank's earnings profile in the near to medium term.

As of December 15, Canara's capitalization profile was adequate with CET-1 at 8.0% supported by regular capital infusion; during 9m, FY2016, the bank has secured equity of about Rs. 1,500 crore by way of preferential allotment to LIC and received Rs. 947 crore of equity from the Government of India (GOI). The bank's total incremental core capital requirement is estimated to be about 80-110%⁵ of the current market capitalization and about Rs. 6,000-7,000 crore of additional tier I capital (AT1). In case of lack of adequate investor appetite for AT1 capital raising, the gap would need to be met through further core capital raising, thereby increasing core capital raising requirements further to 140%-180% of the current market capitalisation. Ability to secure capital in a timely manner would be crucial for business growth as internal generation is expected to be at muted levels as compared to the past trends.

Bank Profile

Canara bank is the one of the large nationalised bank in the country with Govt's stake of 66.30%. Headquartered in Bangalore, Canara bank has a pan India presence and has emerged as a 'financial conglomerate' with seven subsidiaries, one joint venture and three associates. The group consisting of subsidiaries and joint ventures provides a wide range of financial offerings including asset management, online trading, factoring and housing finance. As of Dec-15, the bank had a branch network of 5,794 with about 7.1 crore strong clientele base.

Recent Results

For first nine months of FY2016, the bank reported net profit of Rs. 1,093 crore (Rs. 2,090 crore in 9m, FY2015) on an approx total asset base of Rs. 5.6⁶ lakh crore as of Dec-15 (Rs. 5.3 lakh crore as of Dec-14).

For the financial year FY2015, the bank reported net profit of Rs. 2,703 crore (Rs. 2,438 crore in FY2014) on a total asset base of Rs. 5.4 lakh crore as on March 31, 2015 (Rs. 4.9 lakh crore as on March 31, 2014).

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⁴ DISCOM Assurance Yojana

⁵ Assuming buffer of 1% over and above the regulatory minimum requirement and annualized growth of 10-14% in risk weighted assets during FY17-FY19

⁶ Asset base figures excludes revaluation reserve



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