July 18, 2017

# Vijaya Bank

**Summary of rated instruments**

| Instruments* | Rated Amount (Rs. crore) | Rating Action |
|---|---|---|
| Tier-II bond programme (Basel III) | 1,450.00 | [ICRA]AA+(hyb)(negative); reaffirmed |
| Tier-II bond programme (Basel III) | 50.00 | [ICRA]AA+(hyb)(negative); withdrawn |
| Additional Tier-I bond programme (Basel III) | 1,325.00 | [ICRA]AA-(hyb)(negative); reaffirmed |
| Additional Tier-I bond programme (Basel III) | 425.00 | [ICRA]AA-(hyb)(negative); withdrawn |

**Instruments details are provided in Annexure-1*

**Rating action**

ICRA has reaffirmed the [ICRA]AA+(hyb) (pronounced ICRA double A plus hybrid) rating to the Rs.1,450.00 crore[1] Basel-III compliant Tier-II bond programmes and the [ICRA]AA-(hyb) (pronounced ICRA double A minus hybrid) rating to the Rs. 1,325.00 crore Basel-III compliant Additional Tier-1 bond programme of Vijaya Bank (VB)[2]**.** The outlook on the long-term ratings is negative. ICRA has withdrawn the [ICRA]AA+(hyb) rating outstanding on the Rs. 50.00 crore Basel-III compliant Tier-II bond programme and [ICRA]AA-(hyb) rating outstanding on the Rs. 425.00 crore Basel-III compliant Additional Tier-1 bond programme as requested by the bank, since no funds were raised against these rated instruments and there are no amount outstanding.

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 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 or 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 (CET-1) falls below the limit prescribed by the 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.

[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

Basel III compliant Tier I bonds also have following features, which makes them riskier.

- Coupon payments, which are non-cumulative, are discretionary and the bank has the full discretion at all times to cancel coupon payments.
- Coupon can be paid out of current year profits. However, if the current year profit is not sufficient, or, if the payment of coupon is likely to result in a loss, the coupon payment can be made through reserves and surpluses created through appropriation of profits (including statutory reserves). 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 RBI under Basel III regulations.

**Rationale**

The reaffirmation of the ratings factor in the bank's sovereign ownership, good capitalization profile with CET-1 at 8.4% as on March 31, 2017, moderate operating profitability supported by favourable cost of deposits, good retail franchise especially in south India and comfortable liquidity profile. The bank has maintained its gross NPAs at 6.6% as on March 31, 2017 (same level as on March 31, 2016), which is lower than its peers in similar rating category. The negative outlook considers incremental pressure on the bank's asset quality with standard restructured advances including SDR, S4A and 5/25 at 2.3% of gross advances and other large vulnerable corporate advances of around 1.0% of gross advances as on March 31, 2017. The likely incremental slippages along with ageing of existing NPAs are expected to result in high credit provisioning requirements and impact its profitability in near term. While the bank has increased its NPA provision cover[3] from 29.0% as on March 31, 2016 to 35.5% as on March 31, 2017, the same remains modest compared to its peers in similar rating category. ICRA will continue to monitor the bank's asset quality and earnings going forward and the same would be the key rating sensitivities.

ICRA takes note of the bank's portfolio rebalancing during the last three fiscals with steady increase in the share of non-corporate segments in gross advances, which are more granular in nature and relatively better yielding. As per ICRA's estimates, the bank is relatively better placed in terms of capital to meet Basel III requirements and may not need to depend on government for its capital requirements in near future. The bank is proposing to raise capital through qualified institutional placements (QIP) during FY2018, which would further strengthen its capitalisation profile and enable to grow its advances.

**Key rating drivers**

**Credit strengths**

- Majority government ownership (70.3% as on March 31, 2017) provides comfort on sovereign support, if required
- Comfortable capitalisation profile; plans to further augment the capital base through QIP in FY2018 to support the envisioned credit growth
- Established regional franchise in south India supports overall deposit profile

**Credit weaknesses**

- Moderate asset quality profile with gross NPA at 6.6% as on March 31, 2017; some incremental pressure likely in the near term
- Concentrated credit profile with sizeable exposure to the infrastructure sector (22% of the gross advances as on March 31, 2017)
- Moderate operating profitability and limited diversity in income sources through fee and other income; profitability likely to remain weak in the near term on account of higher credit provisions

[3] (Gross NPA – Net NPA) / Gross NPA

**Rating sensitivities**

- Control of incremental slippages and undertaking effective recoveries would improve the asset quality and profitability with lower credit provisioning requirements.

**Description of key rating drivers:**

The Government of India (GoI) held a 70.3% stake in Vijaya Bank as on March 31, 2017, ensuring sovereign support, if required. The bank has comfortable capitalisation profile with a CET-1 of 8.4% as on March 31, 2017 as against the minimum regulatory requirement of 8.0% by March 2019 aided by moderate internal capital generation and portfolio alignment leading to relatively lower growth in risk weighted assets as compared to total assets. Considering its comfortable capital position, the bank has not received capital from government during FY2017 and ICRA expects the bank to be relatively better placed in terms of capital to meet the Basel III requirements and may not need to depend on government for its capital requirements in near future. The bank proposes to raise capital of around Rs. 1,000 crore (1.2% of risk weighted assets and 13.3% of net worth as on March 31, 2017) in FY2018 through Qualified Institutional placement (QIP), to meet its annual advance growth target of around 10% for the next 2-3 years. During FY2017, the bank's gross advances grew moderately by 7% to Rs. 96,821 crore as on March 31, 2017 with the growth being largely supported by retail (24% growth) and agriculture (14% growth) segments. In the non-corporate segments' share of 67% in gross advances, retail contributed a good share of 30%, followed by MSME (20% share) and agriculture (16% share).

The bank's deposit profile improved during FY2017 with the proportion of CASA deposits in total deposits improving from 23.2% to 28.1% aided by the government's demonetisation and the bank's good retail franchise but continues to be lower than PSB average of 36.7%. The bank has a good liquidity profile with liquidity coverage ratio of 160.5% as on March 31, 2017, as against the minimum regulatory requirement of 80.0%.

The bank maintained its gross NPAs at 6.6% as on March 31, 2017 (same level as on March 31, 2016). However, the standard restructured advances including SDR, S4A and 5/25 at 2.3% and the other vulnerable corporate exposure estimated at around 1.0% could exert some pressure on its asset quality in the near term. VB's share of infrastructure segment in gross advances stood high comparable to its peers at 22.0% as on March 31, 2017, wherein loans to power segment alone contributed 11.6% of gross advances; however, 58.2% of the power segment advances are towards state government entities, thereby mitigating credit risk to some extent.

As on March 31, 2017, with a modest NPA provision cover of 35.5%, the Net NPA stood at of 4.4% and solvency[4] of 54.8%. That being said, any significant hair cut in the NPA resolutions would impact the bank's earnings. Despite good expansion in net interest margin to 2.3% in FY2017 (1.9% in FY2016) aided by favourable cost of deposits, the operating profit improved only marginally to 1.1% (1.0% in FY2016) on account of increase in employee expenses to 1.2% of average total assets (0.9% in FY2016). Nevertheless, good treasury income at 0.5% of average total assets in FY2017 (0.1% in FY2016) due to favourable yield movement have improved the net profitability[5] to 0.5% (0.3% in FY2016). The credit provisioning remained moderate at 0.9% of total average assets in FY2017 (1.0% in FY2016). With steady accretions to the reserves, the bank's distributable reserves, which can be used to service the coupon on its Additional Tier-I (AT-I) bonds stands improved during FY2017. As per ICRA's estimates the distributable reserves[6] stands at 5.0% of RWA as on March 31, 2017 as against 4.5% as on March 31, 2016, which is marginally better compared to PSB average of 4.5% .

4 Net NPA as a proportion of net worth
[5] Profit after tax / Average total assets
[6] As per RBI guidelines revised in February 2, 2017

Going forward, it is critical for the bank to maintain its net interest margin (which results in better net interest income) for good internal capital generation and also cushion the impact of likely higher credit provisioning requirement. Being a relatively well capitalised player in the public sector banking space, VB would witness good overall annual credit growth of around 10% going forward, with focus remaining largely on the non-corporate segments.

**Analytical approach:** For arriving at the rating, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria**
ICRA's Credit Rating Methodology for Banks
Basel III Compliant Non-Equity Capital Instruments

**About the bank:**
Vijaya Bank (VB) is a mid-sized commercial bank, with Government of India holding a majority stake of 70.3% as on March 31, 2017. The bank had a 1.0% share in the banking system advances and 1.3% in deposits as on March 31, 2017. Headquartered in Bangalore, VB has a strong presence in South India, even as it has been extending its reach pan-India. The bank has 2,031 branches and 2,001 ATMs as on March 31, 2017 with 51% of its branches present in South India.

For FY2017, the bank reported a net profit of Rs. 750 crore (Rs. 382 crore in FY2016) on a total asset base of Rs. 1.54 lakh crore as on March 31, 2017 (Rs. 1.45 lakh crore as on March 31, 2016).

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating history for last three years:**

**Table**

| S.No | Instrument | Current Rating | | | Chronology of Rating History for the past 3 years | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Rated Amount (Rs. crore) | FY2018 | FY2017 | FY2016 | | FY2015 |
| | | | | July 2017 | November 2016 | February 2016 | January 2016 | January 2015 |
| 1 | Tier-II bond programme (Basel III) | Long Term | 500 | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (Stable) | [ICRA]AA+ (hyb) (Stable) |
| 2 | | | 500 | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (Stable) | [ICRA]AA+ (hyb) (Stable) |
| 3 | | | 450 | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (Stable) | - |
| 4 | | | 50 | Withdrawn | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (negative) | [ICRA]AA+ (hyb) (Stable) | - |
| 5 | Additional Tier-I bond programme (Basel III) | Long term | 100 | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (Stable) | [ICRA]AA- (hyb) (Stable) |
| 6 | | | 400 | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (Stable) | [ICRA]AA- (hyb) (Stable) |
| 7 | | | 500 | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | - | - |
| 8 | | | 325 | [ICRA]AA- (hyb) (negative) | [ICRA]AA- (hyb) (negative) | - | - | - |
| 9 | | | 425 | Withdrawn | [ICRA]AA- (hyb) (negative) | - | - | - |

**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**

| Instrument | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Rated Amount (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|
| **Tier-II bond programme (Basel III)** | | | | | |
| INE705A08037 | 30-10-2014 | 9.15% | 30-10-2024 | 500.00 | [ICRA]AA+(hyb) (negative) |
| INE705A08052 | 18-02-2015 | 8.62% | 18-02-2025 | 500.00 | |
| INE705A08078 | 22-01-2016 | 8.64% | 22-01-2026 | 450.00 | |
| | | | | | |
| **Additional Tier-I bond programme (Basel III)** | | | | | |
| INE705A08045 | 02-02-2015 | 9.54% | - | 100.00 | |
| INE705A08060 | 27-03-2015 | 10.40% | - | 400.00 | [ICRA]AA-(hyb) (negative) |
| INE705A08086 | 30-03-2016 | 11.25% | - | 500.00 | |
| INE705A08094 | 17-01-2017 | 10.49% | - | 325.00 | |

*Source: VB*

**Name and Contact Details of the Rating Analyst(s):**

**Analyst Contacts**

| | | |
|---|---|---|
| **Mr. Karthik Srinivasan** | **Mr. Anil Gupta** | **Mr. Vivekanandan L** |
| +91 22 6114 3444 | +91 124 4545 314 | +91 44 4297 4306 |
| karthiks@icraindia.com | anilg @icraindia.com | l.vivekanandan@icraindia.com |

**Name and Contact Details of Relationship Contacts:**

**Mr. L. Shivakumar**
+91 22 6114 3406
shivakumar@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**

**Registered Office**
**ICRA Limited**
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

**Corporate Office**
**Mr. Vivek Mathur**
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

| | |
|---|---|
| **Mumbai**<br>**Mr. L. Shivakumar**<br>Mobile: +**91 9821086490**<br>Email: shivakumar@icraindia.com<br><br>3rd Floor, Electric Mansion<br>Appasaheb Marathe Marg, Prabhadevi<br>Mumbai—400025,<br>Board : +91-22-61796300; Fax: +91-22-24331390 | **Kolkata**<br>**Mr. Jayanta Roy**<br>Mobile: **+91 9903394664**<br>Email: jayanta@icraindia.com<br><br>A-10 & 11, 3rd Floor, FMC Fortuna<br>234/3A, A.J.C. Bose Road<br>Kolkata—700020<br>Tel +91-33-22876617/8839 22800008/22831411,<br>Fax +91-33-22870728 |
| **Chennai**<br>**Mr. Jayanta Chatterjee**<br>Mobile: +**91 9845022459**<br>Email: jayantac@icraindia.com<br><br>5th Floor, Karumuttu Centre<br>634 Anna Salai, Nandanam<br>Chennai—600035<br>Tel: +91-44-45964300; Fax: +91-44 24343663 | **Bangalore**<br>**Mr. Jayanta Chatterjee**<br>Mobile: +**91 9845022459**<br>Email: jayantac@icraindia.com<br><br>'The Millenia'<br>Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2,<br>Murphy Road, Bangalore 560 008<br>Tel: +91-80-43326400; Fax: +91-80-43326409 |
| **Ahmedabad**<br>**Mr. L. Shivakumar**<br>Mobile: +**91 9821086490**<br>Email: shivakumar@icraindia.com<br><br>907 & 908 Sakar -II, Ellisbridge,<br>Ahmedabad- 380006<br>Tel: +91-79-26585049, 26585494, 26584924; Fax:<br>+91-79-25569231 | **Pune**<br>**Mr. L. Shivakumar**<br>Mobile: +**91 9821086490**<br>Email: shivakumar@icraindia.com<br><br>5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range<br>Hills Road, Shivajinagar,Pune-411 020<br>Tel: + 91-20-25561194-25560196; Fax: +91-20-<br>25561231 |
| **Hyderabad**<br>**Mr. Jayanta Chatterjee**<br>Mobile: +**91 9845022459**<br>Email: jayantac@icraindia.com<br><br>4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj<br>Bhavan Road, Hyderabad—500083<br>Tel:- +91-40-40676500 | |