Bank of Baroda

June 11, 2018

Summary of Rated Instruments:

Instrument*	Rated Amount (Rs. crore)	Rating Outstanding
Basel III Compliant Tier II Bonds Programme	1,000.00	[ICRA]AAA(hyb)(stable)
Medium Term Deposits	-	MAAA(stable)
Total	**1,000.00**	

Instrument details are provided in Annexure-1

Material event

Bank of Baroda (BOB) announced its results for Q4 FY2018 and FY2018 wherein it reported a net loss of Rs. 3,102 crore during Q4 FY2018 while the net loss for FY2018 was Rs. 2,432 crore. The high quantum of loss was largely because of elevated credit provisions during the year due to increased slippages and increased mark-to-market provisions (MTM) on the investment portfolio resulting from the hardening of yields in H2 FY2018. However, BOB remains better placed than most public sector banks (PSBs), in terms of asset quality, capitalisation and credit growth prospects.

ICRA has the rating outstanding of [ICRA]AAA(hyb) (pronounced ICRA triple A hybrid) for the Rs. 1,000-crore Basel III compliant Tier II bonds programme and the rating of MAAA (pronounced M triple A) for the medium-term deposits programme of BOB. Outlook on the long term and medium term rating is Stable.

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.

Update

BOB reported a net loss of Rs. 3,102 crore in Q4 FY2018 and, accordingly, its full year FY2018 net loss stood at Rs. 2,432 crore. The loss was largely on account of a deterioration in the asset quality post the regulatory changes whereby the Reserve Bank of India (RBI) discontinued all earlier schemes for the resolution of stressed assets and the resultant increase in slippages leading to higher credit costs and losses. Further, with the hardening of yields in H2 FY2018, profitability was affected by increased MTM provisions on the bond portfolio. However, ICRA expects the bank to report profitable operations for FY2019, supported by lower incremental slippages and moderation in credit provisions, with expected improvement in asset quality and recoveries/upgradations of slipped accounts, and a healthy expected loan book growth of 7-10%.

Even though the bank’s asset quality profile deteriorated in FY2018, it is better than that of most PSBs. With an expected reduction in slippages, BOB’s asset quality numbers shall improve by the end of FY2019. The Rs. 5,375-crore capital infusion by the Government of India (GoI) during FY2018 was higher than the losses for the year. Accordingly, despite losses and growth in advances, the bank’s CET and Tier I capital ratios improved during FY2018 to 9.23% and 10.46%, respectively, as against 8.98% and 9.93%, respectively, as on March 2017, against the regulatory requirement of 7.375% and 8.875%, respectively, as on March 31, 2018. Though the bank has availed regulatory dispensation in its FY2018 results, thereby deferring certain provisions totalling Rs. 811 crore, the capital ratios were comfortable even after taking this into account, with adjusted CET1 of 9.03%. While ICRA expects the bank’s equity capital requirement to remain minimal during FY2019, even after considering a 7-10% growth in risk-weighted assets, the bank’s board has approved the raising of additional capital up to Rs. 10,000 crore during FY2019 (including Rs. 6,000 crore of common equity capital) apart from the planned divestment of non-core assets. Further, in case fresh capital is required, BOB has strong ability to raise capital from markets with limited dependence on the GoI. The highest credit quality ratings on BOB's instruments continue to be supported by its majority sovereign ownership (64.03% as on March 31, 2018) and its competitive position in the Indian financial system.

Outlook: Stable

The Stable outlook takes into account BOB's majority sovereign ownership and its competitive position in the Indian banking industry. ICRA expects the bank to continue to maintain a comfortable capital cushion over regulatory requirements and report profitable operations during FY2019. Further, capital requirement, if any, can be met by the bank with limited dependence on the GoI. The outlook will be revised to Negative if the bank's slippages remain high and lead to elevated credit provisions and weaken the capital ratio cushion.

Key rating drivers

Credit strengths

Sovereign ownership with strong market position – The rating factors in BOB's majority sovereign ownership with the GoI's shareholding at 64.03% as on March 31, 2018 and the demonstrated support from the GoI (capital infusion of Rs. 5,375 crore in FY2018). BOB remains one of the key players in the financial sector and is the third-largest PSB in terms of assets and deposits base. The bank's market position is supported by its strong franchise, including a large network of 5,467 branches as on March 31, 2018. Given BOB's market position and its importance to the Indian financial system, ICRA expects the GoI to support the bank if required.

Comfortable capitalisation to support growth – The bank's capitalisation levels remain comfortable with CET1 of 9.23%, Tier 1 of 10.46% and CRAR of 12.13% compared to the regulatory requirement of 7.375%, 8.875% and 10.875%, respectively, as on March 31, 2018. Despite a net loss of Rs. 2,432 crore during FY2018, the bank's capital cushion has remained comfortable subsequent to the GoI's capital infusion of Rs. 5,375 crore during the year. While ICRA expects the bank's equity capital requirement to remain minimal during FY2019, even in a 7-10% growth scenario in risk-weighted assets, the bank's board has approved the raising of additional capital up to Rs. 10,000 crore during FY2019 (including Rs. 6,000 crore of common equity capital) apart from the planned divestment of non-core assets. Further, if fresh capital is required, BOB has strong ability to raise capital from markets with limited dependence on the GoI.

Well-developed deposit franchise with adequate CASA deposit base - The bank has a well-developed deposit franchise resulting in a comfortable current accounts savings account (CASA) ratio. During FY2018, the share of CASA in the bank's deposit profile improved, driven by growth in both current account (CA) and savings account (SA) deposits following demonetisation. As on March 31, 2018, the share of CASA in total deposits stood at 36% vis-à-vis 32% as on March 31, 2017. The percentage of domestic CASA was higher at ~41% as on March 31, 2018.

Credit challenges

Weakened asset quality but expected to improve going forward - The asset quality deteriorated during FY2018, particularly in Q4 FY2018, with the discontinuance of all the earlier schemes for the resolution of stressed assets leading to their slipping into non-performing assets category. BOB also reported a divergence of Rs. 2,919 crore in GNPAs in the RBI's risk-based supervision audit for FY2017. Consequently, its gross and net NPAs increased to 12.26% and 5.49%, respectively, as on March 31, 2018 (10.46% and 4.72%, respectively, as on March 31, 2017). The bank had a total exposure of Rs. 10,998 crore towards both the lists of accounts identified by the RBI for insolvency proceedings against which it had a satisfactory provision of ~55% as on March 31, 2018. Further, BOB had a watchlist consisting of standard stressed exposures, SMA2 accounts and stressed SMA1 accounts amounting to Rs. 10,039 crore (2.1% of gross advances) as on March 31, 2018. Given that a large proportion of the stressed accounts was recognised in FY2018, ICRA expects the slippages to reduce in FY2019 compared to the fresh slippage rate of 7.4% during FY2018 as slippages are likely to remain limited to the bank's watchlist. Supported by recoveries and a decline in fresh slippages, ICRA expects the bank's asset quality to improve in FY2019.

High credit provisions result in losses though profit expected in current year – During FY2018, despite interest reversals with increased slippages, the bank's yields remained stable at 7.17% compared to 7.18% during FY2017. However, with a decrease in the cost of funds and an improved credit-deposit (CD) ratio of 72% as on March 31, 2018 (64% as on March 31, 2017), net interest margins (NIMs) improved to 2.20% of average total assets (ATA) during FY2018 compared to 1.99% during FY2017. With improved NIMs supported by stable non-interest income and operating expenses, the bank reported an increase in core operating profit (excluding treasury income) to 1.44% of ATA during FY2018 from 1.29% of ATA during FY2017. However, the benefit of improved NIMs was offset by increased slippages leading to elevated credit costs (4.04% of ATA in Q4 FY2018 and 2.04% of ATA in FY2018), resulting in a net loss of Rs. 2,432 crore during FY2018 (-0.35% of ATA and return on net worth of -6.32%) compared to a net profit of Rs. 1,383 crore during FY2017 (0.20% of ATA and return on net worth of 3.80%). ICRA expects the bank to report profitable operations in FY2019 with an anticipated improvement in the asset quality and recoveries/upgradations of slipped accounts and a healthy expected loan book growth of 7-10%.

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

Links to applicable criteria:

ICRA Rating Methodology for Banks

About the company

BOB was incorporated in 1908 and was under private ownership and control till July 1969 when it was nationalised along with 13 other banks. The Government of India held a 64.03% stake in the bank as on March 31, 2018. The bank has a widespread domestic network of 5,467 branches (as on March 31, 2018) and a large overseas presence with 105 offices. During the year ended March 31, 2018, BOB reported a loss of Rs. 2,432 crore on total assets of Rs. 7.17 lakh crore compared to a net profit of Rs. 1,383 crore on total assets of Rs. 6.91 lakh crore during the previous year. The bank's gross and net NPA stood at 12.26% and 5.49%, respectively, as on March 31, 2018, against 10.46% and 4.72%, respectively, as on March 31, 2017. The regulatory capital adequacy ratio stood at 12.13% as on March 31, 2018 (Tier 1: 10.46% and CET 1 of 9.23%).

Key financial indicators (audited) – Standalone

Instrument	FY2017	FY2018	Q4FY2017	Q4FY2018
Net Interest Income	13,513	15,522	3,582	4,002
Profit before tax	2,473	-2,791	397	-4,007
Profit after tax	1,383	-2,432	155	-3,102
Net advances	3,83,259	4,27,432	3,83,259	4,27,432
Total assets (adjusted for revaluation reserves)	6,91,299	7,16,843	6,91,299	7,16,843
% CET 1	8.98%	9.23%	8.98%	9.23%
% Tier 1	9.93%	10.46%	9.93%	10.46%
% CRAR	12.24%	12.13%	12.24%	12.13%
% Net interest margin / Average total assets	1.99%	2.20%	2.08%	2.29%
% Net profit/Average total assets	0.20%	-0.35%	0.09%	-1.78%
% Return on net worth	3.80%	-6.32%	1.67%	-31.97%
% Gross NPAs	10.46%	12.26%	10.46%	12.26%
% Net NPAs	4.72%	5.49%	4.72%	5.49%
% Provision coverage ratio excl. technical write offs	57.68%	58.42%	57.68%	58.42%
% Net NPA/ Net worth	49.23%	58.36%	49.23%	58.36%

Amounts in Rs. crore; All ratios are as per ICRA calculations
Source: BOB; ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the past 3 years			
						FY2018		FY2017	FY2016
Sr. No.	Name of Instrument	Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	June 2018	Oct-17	Jun-17	Jul-16	Jul-15
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AAA (hyb) (stable)	[ICRA]AAA (hyb) (stable)	[ICRA]AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)
2	Term Deposits Programme	Long Term	NA	NA	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)
3	Basel II Compliant Tier II Bonds Programme	Long Term	-	-	-	-	-	[ICRA] AAA (stable) withdrawn	[ICRA] AAA (stable)
4	Certificate of Deposit Programme	Short Term	-	-	-	-	[ICRA]A1+ withdrawn	[ICRA]A1+	[ICRA]A1+
5	Corporate Governance Rating	-	-	-	CGR2	CGR2	CGR2	CGR2	CGR2

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE028A08059	Basel III Compliant Tier II Bonds Programme	17-Dec-2013	9.73%	17-Dec-2023	1,000	[ICRA]AAA(hyb)(stable)
NA	Medium-term Deposits	-	-	-	-	MAAA(stable)

Source: BOB

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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

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