Bank of Baroda

April 26, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds Programme	1,000.00	1,000.00	[ICRA]AAA(hyb); 'rating watch with developing implications' removed and 'stable 'outlook assigned
Medium-term Fixed Deposit Programme	-	-	MAAA; 'rating watch with developing implications' removed and 'stable' outlook assigned
Total	**1,000.00**	**1,000.00**	

**Instrument details are provided in Annexure-1*

Summary of rating action (erstwhile Vijaya Bank transferred to BoB)

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bond Programme	1,450.00	1,450.00	[ICRA]AAA (hyb) (Stable); assigned
Basel III Compliant Additional Tier I Bond Programme	1,325.00	1,325.00	[ICRA]AA (hyb) (Stable); assigned
Total	**2,775.00**	**2,775.00**	

**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 rating for the bank's Basel III compliant Tier I bonds is two notches below the Basel III compliant Tier II bonds as these instruments have the following loss-absorption features that make them riskier:

• Coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel coupon payments. Cancellation of discretionary payments shall not be an event of default.

• Coupons can be paid out of current year profits. However, if the current year profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made through reserves and surpluses[1] created through the appropriation of profits (including statutory reserves). As per ICRA's estimates, these reserves and surpluses stood at 4.46% of the risk-weighted assets (RWAs) for the merged entity as on December 31, 2018. 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 Reserve Bank of India (RBI) under Basel III regulations.

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 (CET I) ratio, as prescribed by the RBI. The ratio is 5.5% before March 31,

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[1] Calculated as per the amendment in Basel III capital regulations for AT-I bonds by the RBI, vide its circular dated February 2, 2017. As per the amended definition, distributable reserves include all reserves created through appropriations from the profit and loss account

2019 and 6.125% thereafter of the total RWAs of the bank or when the point of non-viability (PONV) trigger is breached, in the RBI's opinion.

Rationale

The rating actions take into account the conclusion of the merger between Bank of Baroda (BoB), Vijaya Bank and Dena Bank, with the merger being effective from April 1, 2019 (hereafter, the merged entity is referred to as BoB-M). Furthermore, the ratings factor in the capital infusion by the Government of India (GoI) as a part of its plan to shore up the capital position of the merged bank, particularly given the relatively weaker capitalisation of Dena Bank. The quantum of capital infusion, at Rs. 5,042 crore in March 2019, largely remains in line with ICRA's estimates of the merged entity's capital requirement at Rs. 5,500-6,000 crore till FY2020. With the capital infusion and the conclusion of the merger, ICRA estimates that BoB-M is now the third largest bank in the Indian banking sector and the second largest public sector bank (PSB). Going forward, in ICRA's view, BoB-M will maintain adequate capital buffers while remaining geared to grow at 7-8% in RWAs in FY2020. Although higher growth could lead to capital requirement for maintaining a capital cushion in FY2020, the same is expected to remain limited. Moreover, in ICRA's view, BoB-M is likely to be classified as a domestically systemically important bank (D-SIB), given its scale.

Furthermore, the ratings continue to factor in the moderation in the fresh addition of non-performing assets (NPAs) for BoB-M in 9M FY2019, which ICRA expects will continue in FY2020. This will lead to a reduction in BoB-M's net NPA (NNPAs) to 2.8-2.9% of standard advances in FY2020 with expected solvency levels (net NPA/net worth) of 25-30% as on March 31, 2020. Lower slippages curtailed the trend of losses in 9M FY2019 even though profitability remained weak because of elevated provisioning levels. The ratings also remain supported by the majority sovereign ownership of the bank as well as the demonstrated capital infusion by the GoI into various PSBs, including BoB, in the past.

The rating actions factor in the strong franchise of the merged entity, imparting a healthy and stable deposits base and a sound liquidity profile. BoB-M's domestic current account and savings account (CASA) deposits stood at 33.21% as on December 31, 2018, below the CASA of 34.99% for BoB. This was mainly due to the relatively higher term deposit base of erstwhile Vijaya Bank. Nevertheless, the sizeable share of retail deposits is a positive from a cost of funds as well as liquidity perspective. ICRA takes further comfort from BoB-M's provision coverage (without write-offs) of 59% as on December 31, 2018 (PSB average of ~56% as on December 31, 2018). The high provision coverage is also expected to provide cushion to the net profitability as the stressed accounts undergo resolution.

BoB-M's earnings profile is expected to be better in FY2020E[2] compared to FY2019E with an estimated return on assets (RoA) of 0.4-0.6% for FY2020, thereby supporting internal capital generation to some extent. ICRA expects BoB-M to maintain enough capital cushion (more than 1% above the regulatory levels[3] at the CET I and Tier I levels), which will remain critical for the current rating levels apart from the earnings and asset quality levels highlighted above.

Outlook: Stable

In ICRA's opinion, BoB-M is expected to maintain adequate capital cushion above the regulatory requirements while the asset quality and earnings profile are likely to improve in FY2020. The outlook may be revised to Negative if the deterioration in the asset quality is above the anticipated level, thereby leading to elevated credit costs, or if the bank's

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[2] *(E) ICRA estimates*

[3] *Including additional capital buffer, if classified as D-SIB*

capital metrics weaken beyond estimated levels. Furthermore, BoB-M's ability to handle post-merger integration related challenges, including the streamlining of various functions of the constituent banks in a timely manner, as well as contain the merger-related impact will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Sovereign ownership; adequate capital support before merger – The GoI remains the major shareholder of the merged bank with its shareholding at 65.37% as on April 1, 2019. The GoI has demonstrated capital infusion in all PSBs including BoB. It infused equity capital of Rs. 5,735 crore in FY2018 and an additional Rs. 5,042 crore in March 2019, to shore up the capital position before the merger. The capital infusion broadly remains in line with ICRA's estimates for the merged bank at Rs. 5,500-6,000 crore in FY2020.

Merger has created second largest PSB in terms of total asset base; BoB-M likely to be classified D-SIB – Prior to the merger, BoB was the third largest PSB, in terms of its asset base, and the fifth largest bank with a market share of 4.8% in the Indian banking sector. With the merger, BoB-M will become the second largest PSB with an estimated market share of 7.2% of the total assets of the Indian banking sector as on December 31, 2018. Consequently, ICRA expects the merged entity to be classified as a domestic systemically important bank (D-SIB) by the regulatory authority. BoB-M is expected to have a strong franchise, supported by the second largest network of over 9,400 branches across India as on December 31, 2018.

Capital infusion prior to merger will help sustain growth in FY2020 – The capital ratios of the merged entity are estimated at CET I of 8.77%, Tier I of 9.86% and CRAR of 11.82% as on December 31, 2018 against the regulatory requirement of 7.375%, 8.875% and 10.875%, respectively, as on March 31, 2019. The recent capital infusion will add 0.87% to the capital ratios, based on RWAs as on December 31, 2018. The D-SIB classification would pose an additional CET I requirement of 0.3-0.4% of RWA from FY2020. With an expected RoA of 0.4-0.6% and a blended growth of 7-8% in RWAs in FY2020, the additional CET I requirement if classified as a D-SIB, and cushion of at least 1% over the regulatory levels (to remain consistent with the rating category), ICRA expects BoB-M's equity capital requirements to be manageable at <5% of the market capitalisation in FY2020[4] in a high growth scenario.

Well-developed deposit franchise for BoB-M even though Vijaya's bulky term deposit base to moderate share of CASA in total deposits – BoB had a well-developed deposit franchise resulting in a comfortable CASA ratio of 39.98% for domestic operations and 34.99% for global operations as on December 31, 2018. This will, however, be offset by the lower CASA deposit base of Vijaya, which, prior to the merger, operated with a relatively higher degree of dependence on bulk deposits. This kept its CASA at a lower level (22.32% as on December 31, 2018). On the other hand, Dena reported a CASA between 37% and 41% over the last few quarters, albeit on a smaller base. Going forward, BoB-M is expected to have a lower CASA base of ~33%, below the ~39% level for PSBs, although Vijaya's strong franchise in South India along with Dena's pan-India branch network will boost BoB's strong franchise.

Credit challenges

Internal accruals likely to improve in FY2020 although return metrics to remain subdued – Supported by a YoY growth of ~11% in advances and lower interest reversals driven by reduced slippages, BoB-M's NII increased by 16% to Rs. 37,908 crore in 9M FY2019 (Rs. 32,687 crore in 9M FY2018). This also supported a 22% YoY growth in core operating

[4] *Assuming a 1% buffer over regulatory capital levels*

profits[5] to Rs. 12,146 crore (Rs. 9,941 crore in 9M FY2018) during this period. The credit provisions and other provisions (including mark-to-market provisions on the bond portfolio) remained at comparatively lower levels of Rs. 11,616 crore (Rs. 11,848 crore) that led to a containment of net losses at Rs. 93 crore (net loss of Rs. 1,575 crore in 9M FY2018).
Among the merging banks, Vijaya reported profitable operations in 9M FY2019 with a net profit of Rs. 428 crore while Dena reported net losses of Rs. 1,317 crore leading to suppressed profitability for the merged entity. Net losses resulted in a negative RoA and return on net worth (RoNW). Going forward, depending on the credit provisions, ICRA expects the RoA of the merged entity to improve but remain weak at 0.4-0.6% in FY2020. Accordingly, this will support internal capital generation, to an extent. However, there could be increased reliance on additional capital to maintain the capital cushions above the regulatory levels, particularly if the bank pushes for higher growth in FY2020.

Weaker asset quality of merged bank; credit costs to remain elevated – BoB-M’s slippages moderated in 9M FY2019 (GNPA addition of Rs. 19,596 crore – 4.56% (annualised) of standard advances), though the GNPA addition was lower than the recoveries, upgrades and write-offs of Rs. 25,641 crore. This led to a reduction in GNPAs and NNPAs to Rs. 74,322 crore (10.91%) and Rs. 30,569 crore (4.80%), respectively, as on December 31, 2018. The provision coverage ratio (excluding write-offs) remained good at 59% for BoB compared to 56% for PSBs as on December 31, 2018. With elevated levels of NNPAs, the solvency ratio (Net NPA/Net worth) before capital infusion stood at 52.06% on December 31, 2018, which is expected to have improved to 28-29% following the recent capital infusion.
Going forward, ICRA expects slippages for the merged entity to reduce to 2.2-2.8% of standard advances in FY2020. Furthermore, supported by recoveries, upgrades and write-offs, and increased provisioning, ICRA expects the bank’s NNPAs to reduce with expected NNPA of 2.8-2.9% by March 2020, with an estimated provision cover (without TWO) of 73-75%. The merged bank’s solvency level is expected to improve to 25-30% by March 2020. Notwithstanding the expected reduction in NNPAs, the credit cost is expected to remain elevated at 1.1-1.5% of ATA, which shall continue to translate into weak RoA of 0.4-0.6% in FY2020. Moreover, unless supported by large recoveries from NPAs, the credit provisions can remain elevated, translating into moderate internal accruals even in FY2020.

Liquidity position

BoB had SLR investments of Rs. 1,52,633 crore (29.35% of NDTL), much higher than the regulatory requirement of 19.5% of NDTL as on December 31, 2018, which provides a liquidity cushion for the bank. ICRA expects BoB-M to maintain comfortable liquidity, given its large proportion of retail deposits, access to call money markets and to the repo and marginal standing facility mechanism of the RBI in case of urgent liquidity needs.

[5] *Before treasury income/losses and credit provisions*

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The ratings factor in BoB-M's sovereign ownership and demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support BoB-M with capital infusion, if required.
Consolidation/Standalone	The ratings are based on the standalone financial statements of BoB and the consolidated financials estimates of ICRA for the merged entity.

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. Post-merger, the GoI held a stake of 65.37% in the bank as on April 1, 2019. Prior to the merger, BoB operated a widespread domestic network of 5,546 branches (as on December 31, 2018) and had a large overseas presence with 101 offices. For 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 in the previous year.

For 9M FY2019, the bank reported a net profit of Rs. 1,425 crore (Rs. 671 crore in 9M FY2018) on a total asset base of Rs. 7.44 lakh crore as on December 31, 2018 (Rs. 6.80 lakh crore as on December 31, 2017).

Key financial indicators (audited) – Bank of Baroda

	FY2017	FY2018	9M FY2018	9M FY2019
Net interest income	13,513	15,522	11,520	13,617
Profit before tax	2,473	-2,791	1,216	2,237
Profit after tax	1,383	-2,432	671	1,425
Net advances	3,83,259	4,27,432	3,99,381	4,48,679
Total assets (adjusted for revaluation reserves)	6,91,299	7,16,843	6,79,585	7,44,468
% CET 1	8.98%	9.23%	8.28%	8.65%
% Tier 1	9.93%	10.46%	9.52%	9.86%
% CRAR	12.24%	12.13%	11.55%	11.67%
% Net interest margin/Average total assets	1.99%	2.20%	2.24%	2.48%
% Net profit/Average total assets	0.20%	-0.35%	0.13%	0.26%
% Return on net worth	3.80%	-6.32%	2.41%	4.64%
% Gross NPAs	10.46%	12.26%	11.33%	11.02%
% Net NPAs	4.72%	5.49%	4.97%	4.26%
% Provision coverage ratio excl. technical write-offs	57.68%	58.42%	59.05%	64.03%
% Net NPA/ Net worth	49.23%	58.36%	53.08%	45.92%

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

Vijaya Bank

Vijaya Bank is a mid-sized commercial bank, with the GoI holding a majority stake of 68.77% as on December 31, 2018. The bank had a share of about 1.6% in the banking system advances and deposits as on December 31, 2018. Headquartered in Bangalore, Vijaya Bank has a strong presence in South India, even as it has been extending its reach across India. The bank had 2,119 branches and 2,162 ATMs as on December 31, 2018.

For 9M FY2019, the bank reported a net profit of Rs. 428 crore (Rs. 520 crore in 9M FY2018) on a total asset base of Rs. 1.94 lakh crore as on December 31, 2018 (Rs. 1.64 lakh crore as on December 31, 2017).

Key financial indicators (audited) – Vijaya Bank

	FY2017	FY2018	9M FY2018	9M FY2019
Net Interest Income	3,506	4,303	3,106	3,559
Profit before tax	914	983	696	542
Profit after tax	750	727	520	428
Net advances	94,549	1,16,165	1,08,101	1,29,784
Total assets (adjusted for revaluation reserves)	1,54,051	1,76,841	1,64,473	1,94,841
% CET 1	8.44%	10.36%	8.26%	9.95%
% Tier 1	9.96%	11.71%	9.67%	11.25%
% CRAR	12.73%	13.90%	12.26%	13.39%
% Net interest margin / Average total assets	2.34%	2.60%	2.60%	2.55%
% Net profit/Average total assets	0.50%	0.44%	0.44%	0.33%
% Return on net worth	10.67%	8.47%	8.75%	6.11%
% Gross NPAs	6.59%	6.34%	6.17%	6.14%
% Net NPAs	4.36%	4.32%	3.99%	4.08%
% Provision coverage ratio excl. technical write offs	35.47%	33.28%	36.79%	34.94%
% Net NPA/ Net-worth	56.25%	51.04%	50.66%	51.60%

Note: Amounts in Rs. crore, All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Sr. No.	Name of Instrument	Current Rating (FY2020) Type	Rated Amount (Rs. crore)	Amount Outstanding (Rs. crore)	Apr-19	Chronology of Rating History for the Past 3 Years FY2019 Nov-18	Sep-18	Jun-18	FY2018 Oct-17	Jun-17	FY2017 Jul-16
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AAA (hyb) (stable)	[ICRA]AAA (hyb) &	[ICRA]AAA (hyb) &	[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 &	MAAA &	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)
3	Basel II Compliant Tier II Bonds Programme	Long Term	-	-	-	-	-	-	-	-	[ICRA]AAA (stable) withdrawn
4	Certificates of Deposit Programme	Short Term	-	-	-	-	-	-	-	[ICRA]A1+ withdrawn	[ICRA]A1+
5	Basel III Compliant Tier II Bonds Programme (erstwhile Vijaya Bank)	Long Term	1,450	1,450	[ICRA]AAA (hyb) (stable) Assigned						
6	Basel III Additional Tier I Bonds (erstwhile Vijaya Bank)	Long Term	1,325	1,325	[ICRA]AA (hyb) (stable) Assigned						

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

Instrument details of erstwhile Vijaya Bank (transferred to BoB)

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE705A08037	Tier II Bonds – Basel III	30-10-2014	9.15%	30-10-2024	500.00	[ICRA]AAA (hyb) (Stable); Assigned
INE705A08052	Tier II Bonds – Basel III	18-02-2015	8.62%	18-02-2025	500.00	[ICRA]AAA (hyb) (Stable); Assigned
INE705A08078	Tier II Bonds – Basel III	22-01-2016	8.64%	22-01-2026	450.00	[ICRA]AAA (hyb) (Stable); Assigned
INE705A08045	Additional Tier I Bonds – Basel III	02-02-2015	9.54%	-	100.00	[ICRA]AA (hyb) (Stable); Assigned
INE705A08060	Additional Tier I Bonds – Basel III	27-03-2015	10.40%	-	400.00	[ICRA]AA (hyb) (Stable); Assigned
INE705A08086	Additional Tier I Bonds – Basel III	03-03-2016	11.25%	-	500.00	[ICRA]AA (hyb) (Stable); Assigned
INE705A08094	Additional Tier I Bonds – Basel III	17-01-2017	10.49%	-	325.00	[ICRA]AA (hyb) (Stable); Assigned

Source: Vijaya Bank

Annexure-2: List of entities considered for consolidated analysis

ICRA has considered the consolidated financial estimates for Bank of Baroda with Vijaya Bank and Dena Bank for analytical purposes, given the recently concluded merger of these three entities.

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