

Vijaya Bank

August 06, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Tier II Bonds Programme – Basel III	1,450.00	1,450.00	[ICRA]AA+ (hyb) (Stable) / Reaffirmed, outlook revised from Negative
Additional Tier I Bonds Programme – Basel III	1,325.00	1,325.00	[ICRA]AA- (hyb) (Stable) / Reaffirmed, outlook revised from Negative
Total	2,775.00	2,775.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the [ICRA]AA+ (hyb) (pronounced ICRA double A plus hybrid) rating on the Rs. 1,450.00-crore¹ Basel III compliant Tier II bonds programme and the [ICRA]AA- (hyb) (pronounced ICRA double A minus hybrid) rating on the Rs. 1,325.00-crore Basel III compliant Additional Tier I bonds programme of Vijaya Bank². The outlook on the long-term rating has been revised to Stable from 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 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 done through reserves and surpluses created through the appropriation of profits (including statutory reserves)³. 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, 2019 and 6.125% thereafter of the total risk-weighted assets (RWAs) of the bank or when the point of non-viability (PONV) trigger is breached, in the RBI’s opinion.

¹ 100 lakh = 1 crore = 10 million

² For complete rating scale and definitions, please refer to ICRA’s website (www.icra.in) or other ICRA rating publications

³ The reserves, which can be used for coupon servicing in a year of loss, stood comfortable at 5.1% of RWAs as on June 30, 2018

Rationale

The revision in the rating outlook factors in our expectation that the bank's incremental slippages are likely to stabilise at a lower level. This shall support its incremental profitability and capitalisation profile despite increased regulatory requirements by March 2019⁴. The capitalisation levels are also expected to be sufficient to support the envisaged credit growth of 15% without any incremental equity capital requirements in the near term. While the slippages are expected to decline to 2.2-2.7% during FY2019, the credit provisions are likely to remain elevated at 1.0-1.3% of average total assets (ATA) resulting in muted profitability. During FY2018, the bank reported muted net profitability⁵ of 0.44% compared to 0.50% in FY2017 on account of elevated credit costs attributed to higher-than-expected slippages. However, despite the muted profitability, the bank reported comfortable capital indicators with CET I of 10.36%, Tier I of 11.71% and total capital to risk-weighted assets ratio (CRAR) of 13.90% compared to the regulatory requirements (including CCB of 1.875%) of CET I of 7.375%, Tier I of 8.875% and CRAR of 10.875% as on March 31, 2018. The capital ratios were supported by equity infusion of Rs. 1,277 crore by the Government of India (GoI) during Q4 FY2018 and a qualified institutional placement (QIP) of Rs. 700 crore by the bank during Q2 FY2018. While ICRA expects the bank's equity capital requirement to be minimal, ICRA believes that in the event of fresh capital requirement, the bank should be able to raise capital from the markets with limited reliance on the GoI, while maintaining majority GoI shareholding.

The ratings continue to factor in Vijaya Bank's sovereign ownership with the GoI holding a 68.77% stake in the bank as on March 31, 2018, its established franchise in South India with a growing branch network, and its improving net interest margins (NIM) supported by a decline in the cost of funds post demonetisation. However, given its high dependence on bulk deposits and the increasing rate environment, the bank's ability to maintain competitive cost of funds will be critical for its profitability. The share of low-cost current account and savings account (CASA) deposits remained low at 25% as on March 31, 2018 (compared to the public sector bank (PSB) average of 38%) resulting in higher cost of interest-bearing funds compared to peers. Going forward, Vijaya Bank's ability to scale up its business, strengthen its overall franchise and improve its deposit profile while maintaining good asset quality and capital metrics would be key rating sensitivities.

Outlook: Stable

ICRA expects the bank to continue to maintain a comfortable asset quality and earnings profile and a capital cushion above the regulatory requirements. The outlook may be revised to Positive if the bank is able to report sustained business growth, strengthen its franchise and improve its deposit profile. The outlook may be revised to Negative if the bank's asset quality deteriorates significantly leading to higher slippages and elevated credit costs or if the bank's capital metrics weaken.

Key rating drivers

Credit strengths

Majority Government ownership provides sovereign support – Vijaya Bank is a mid-sized PSB with an advances and deposit base of Rs. 1.18 lakh crore and Rs. 1.57 lakh crore, respectively, and a market share of ~1.4% in advances and deposits as on March 31, 2018. The GoI held a 68.77% stake in the bank as on March 31, 2018, which provides comfort by way of sovereign support, if required. The GoI infused total capital of Rs. 1,497 crore in Vijaya Bank in the last three years, including Rs. 1,277 crore that was infused in FY2018 as part of the GoI's public sector banks recapitalisation programme. This has supported the bank's capitalisation profile, which was comfortable with CET I of 10.36% as on March 31, 2018. An increase in the GoI's stake during Q4 FY2018 also provides scope for Vijaya Bank to raise equity

⁴ CET I of 8.0%, Tier I of 9.5% and CRAR of 11.5% as on March 31, 2019 including CCB of 2.5%

⁵ Profit after tax / average total assets

capital from market sources while maintaining the majority sovereign ownership, thereby reducing dependence on the GoI for capital requirements.

Comfortable capitalisation indicators – Vijaya Bank's capitalisation profile remained comfortable with CET I of 10.36%, Tier I of 11.71% and capital adequacy ratio of 13.90% as on March 31, 2018 against the regulatory requirement of 8.00%, 9.50% and 11.50% (including CCB of 2.5%), respectively, for March 31, 2019. Despite accruals being impacted to a certain extent by elevated provisioning during FY2018, the bank's capital ratios were supported by equity infusion of Rs. 1,277 crore by the GoI during Q4 FY2018 and QIP of Rs. 700 crore during Q2 FY2018. The bank has deferred its capital infusion plans for FY2019. However, given its adequate capitalisation position, ICRA believes that the bank is well placed to achieve the envisaged growth of about 15% and maintain a cushion over Basel III capital norms for March 2019 without any additional equity capital infusion.

Established franchise in South India – Vijaya Bank has a long-standing presence and established retail franchise in South India with a total branch network of 2,136 as on March 31, 2018. The bank reported healthy YoY growth in advances (22.6%) and deposits (18.3%) during FY2018 to Rs. 1.18 lakh crore and Rs. 1.57 lakh crore, respectively, as on March 31, 2018. The growth in advances was broad-based across the retail and corporate segments while the deposit growth was largely driven by expansion in bulk deposits, thereby reducing the share of CASAs to 25.04% as on March 31, 2018 from 28.10% as on March 31, 2017. Going forward, with an expanding branch footprint and focus on increasing the retail deposit base, the CASA balances are expected to improve. However, if the bank pursues high credit and hence deposit growth, the CASA ratios may not improve materially. The bank also has a good liquidity profile with a liquidity coverage ratio of 129.94% as on March 31, 2018 against the regulatory requirement of 90%.

Credit challenges

NPA remains elevated though much lower than peers – Vijaya Bank's gross non-performing assets (GNPA) and net non-performing assets (NNPA) remained elevated at 6.34% and 4.32%, respectively, as on March 31, 2018 (6.59% and 4.36%, respectively, as on March 31, 2017). ICRA expects the pressure on asset quality to continue in the near term with standard restructured accounts including SDR, S4A and 5/25 at about 1.0% of gross advances in addition to other corporate vulnerable exposures. However, the slippages for FY2019 shall be lower than the FY2018 level and are estimated to be about 2.2-2.7%. Further, as on March 31, 2018, the bank's NPA provision cover (excluding technical write-offs) was moderate at 33.3% (35.5% as on March 31, 2017) compared to the PSB average of 49%, though this was also because of lower GNPA levels in relation to the PSB average. The bank's GNPA and NNPA were below the PSB average of 14.6% and 8.0%, respectively, as on March 31, 2018. Accordingly, the bank's solvency ratio (net NPA/net worth) stood at 51.04% as on March 31, 2018. Although the bank's solvency ratio was weak, it was better than the PSB average of 88%. Because of the low provision cover, the bank's provisioning requirement for FY2019 is likely to remain high at 1.0-1.3% of ATA. Further, while Vijaya Bank's share of infrastructure advances remained relatively high at 23.4% of total gross credit as on March 31, 2018, ICRA notes that these advances are predominantly towards state government entities, thereby mitigating credit risk to some extent. Going forward, improvement in the bank's asset quality indicators would depend on the overall pickup in the business environment and the bank's ability to control incremental slippages and undertake effective recoveries.

Profitability expected to remain moderate – Vijaya Bank's return on assets (RoA) for FY2018 was impacted by the elevated credit provisions resulting from higher slippages during the year. The bank's RoA for FY2018 was muted at 0.44% compared to 0.50% in FY2017. With 22.6% YoY growth in advances, the bank's net interest income (NII) witnessed a strong growth of 22.7% during FY2018. Consequently, the bank's net interest margins expanded to 2.59% in FY2018 (compared to 2.34% in FY2017) driven by lower cost of funds and an improved credit/deposit ratio. The operating expenses were also curtailed with operating expenses/ATA declining to 1.70% during FY2018 from 1.83% during FY2017. Accordingly, the bank's core operating profit improved to 1.54% of ATA during FY2018 from 1.11% during FY2017. However, the improvement in net profitability was weighed down by lower treasury income and higher credit provisions

of 1.05% of ATA in FY2018 compared to 0.90% in FY2017. ICRA notes that the bank's credit provisioning requirement for FY2019 is likely to remain high at 1.0-1.3% of ATA given its current moderate provision cover and incremental provisions for fresh slippages, accounts referred to National Company Law Tribunal (NCLT) and restructured accounts. Further, with an increase in the overall bond yield, the bank's incremental trading profit is expected to be subdued. Consequently, the bank's ability to maintain good NIMs, and control operating expenses and slippages would be critical from a net profitability perspective. For FY2019, ICRA expects the bank's profitability indicators to remain largely stable at 0.4-0.6% of ATA.

High dependence on bulk deposits, profitability susceptible to rise in bulk deposit rates - During FY2018, Vijaya Bank's deposits grew by 18.3% (YoY) mainly driven by strong traction in term deposits, which increased 23.3% YoY while CASA grew by a modest 5.3%, albeit on a high base. Post demonetisation, the bank's CASA balances grew by 28.4% on a YoY basis as on March 31, 2017 taking the CASA share to 28.1% of total deposits from 23.2% as on March 31, 2016. In line with stronger growth in term deposits, the bank's share of CASAs declined to 25.0% as on March 31, 2018. Within term deposits, the bank's concentration towards bulk deposits also increased with the top 20 depositors accounting for 24.3% of the overall deposits as on March 31, 2018 compared to 19.92% as on March 31, 2017. Though the profile of the top depositors primarily includes government entities, thereby ensuring stickiness of the deposits, it exposes the bank's profitability to a rise in bulk deposit rates. Because of comfortable liquidity conditions during the last few years, the quality of these bulk deposits improved with reduced reliance on differential rate deposits, which helped reduce its overall cost of funds. Nonetheless, ICRA notes that the bank would have to improve the profile of its deposits as this is crucial for the long-term stability of the cost of funds.

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

Vijaya Bank is a mid-sized commercial bank, with the GoI holding a majority stake of 68.8% as on March 31, 2018. The bank had a share of about 1.4% in the banking system advances and deposits as on March 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 2,136 branches and 2,155 ATMs as on March 31, 2018.

For FY2018, the bank reported a net profit of Rs. 727 crore (Rs. 750 crore in FY2017) on a total asset base of Rs. 1.76 lakh crore as on March 31, 2018 (Rs. 1.54 lakh crore as on March 31, 2017).

Key financial indicators

	FY2017	FY2018	Q1 FY2018	Q1 FY2019
Net Interest Income (Rs. crore)	3,506.44	4,302.89	943.80	1,206.72
Profit before Tax (Rs. crore)	147.87	440.29	329.35	192.79
Profit after Tax (Rs. crore)	750.48	727.03	254.69	144.32
Net Advances (Rs. crore)	94,548.89	116,165.44	91,327.00	119,666.27
Total Assets (Rs. crore) (adjusted for revaluation reserve)	154,051.11	176,841.53	152,118.04	177,646.20
% CET 1	8.44%	10.36%	8.47%	10.35%
% Tier 1	9.96%	11.71%	10.01%	11.70%
% CRAR	12.73%	13.90%	12.73%	13.91%
% Net Interest Margin / Average Total Assets	2.34%	2.60%	2.47%	2.72%
% Net Profit / Average Total Assets	0.50%	0.44%	0.67%	0.32%
% Return on Net Worth	10.25%	7.39%	13.68%	5.40%
% Gross NPAs	6.59%	6.34%	7.30%	6.19%
% Net NPAs	4.36%	4.32%	5.24%	4.10%
% Provision Coverage incl Technical Write-offs	58.15%	59.39%	56.01%	61.18%
% Net NPA / Net Worth	56.25%	51.04%	63.15%	45.57%

Note: Amounts in Rs. crore

Source: Vijaya Bank, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Type	Current Rating (FY2019)		Aug 2018	Chronology of Rating History for the past 3 years			
		Amount rated (Rs. crore)	Amount Outstanding (Rs. crore)		FY2018	FY2017	FY2016	
Tier-II Bonds – Basel III	Long Term	500.00	500.00	[ICRA]AA+ (hyb)	[ICRA]AA+ (hyb)	[ICRA]AA+ (hyb)	[ICRA]AA+ (hyb)	[ICRA]AA+ (hyb)
		500.00	500.00	(Stable)	(Negative)	(Negative)	(Negative)	(Stable)
		450.00	450.00					
Additional Tier-I Bonds – Basel III	Long Term	100.00	100.00	[ICRA]AA- (hyb)	[ICRA]AA- (hyb)	[ICRA]AA- (hyb)	[ICRA]AA- (hyb)	[ICRA]AA- (hyb)
		400.00	400.00	(Stable)	(Negative)	(Negative)	(Negative)	(Stable)
		500.00	500.00					
		325.00	325.00					

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
INE705A08037	Tier II Bonds – Basel III	30-10-2014	9.15%	30-10-2024	500.00	[ICRA]AA+ (hyb) (Stable)
INE705A08052	Tier II Bonds – Basel III	18-02-2015	8.62%	18-02-2025	500.00	[ICRA]AA+ (hyb) (Stable)
INE705A08078	Tier II Bonds – Basel III	22-01-2016	8.64%	22-01-2026	450.00	[ICRA]AA+ (hyb) (Stable)
INE705A08045	Additional Tier I Bonds – Basel III	02-02-2015	9.54%	-	100.00	[ICRA]AA- (hyb) (Stable)
INE705A08060	Additional Tier I Bonds – Basel III	27-03-2015	10.40%	-	400.00	[ICRA]AA- (hyb) (Stable)
INE705A08086	Additional Tier I Bonds – Basel III	03-03-2016	11.25%	-	500.00	[ICRA]AA- (hyb) (Stable)
INE705A08094	Additional Tier I Bonds – Basel III	17-01-2017	10.49%	-	325.00	[ICRA]AA- (hyb) (Stable)

Source: Vijaya Bank

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