Bank of India

March 13, 2019

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Deposit Programme	-	-	MAA+ reaffirmed: Outlook revised to Stable from Negative
Total			

Rationale

The revision in the outlook factors in the sizeable equity infusion of Rs. 14,724 crore in Bank of India (BOI) as a part of the bank recapitalisation plan of the Government of India (GoI) for FY2019. The capital infusion has enabled BOI to bring its net non-performing advances (NNPAs) below 6.0%, the criterion for inclusion in the prompt corrective action (PCA) framework of the Reserve Bank of India (RBI), while shoring up its capital ratios above the regulatory levels (including the capital conservation buffer- CCB). These steps have supported the exit of the bank from the PCA framework, which is a positive from a credit perspective.

The quantum of capital allocated to the bank, coupled with the removal of lending restrictions following its exit from the PCA, is expected to support growth in advances in FY2020. Going forward, slippages may remain elevated in Q4 FY2019 as well (6.3% - annualised in 9M FY2019), given the SMA[1] 1 and 2 accounts of ~4% of advances as on December 31, 2018, though they are expected to decline in FY2020. Further, supported by recoveries and write-offs, the gross NPAs (GNPAs) shall continue to taper, going forward. With upfront provisioning for stressed assets, the credit provisions are also estimated to decline in FY2020 and ICRA expects the bank to report profitable operations in FY2020 even though the return on assets (RoA) will remain weak at <0.4-0.5%. With estimated growth of 8-9% in risk-weighted assets (RWA) and profits in FY2020, ICRA estimates BOI's incremental equity capital requirement at Rs. 1,250 crore (~5% of the current market capitalisation) in FY2020, assuming the bank maintains a cushion of 50 bps over the regulatory Tier I of 9.50%, as on March 31, 2020. BOI's capital requirement is expected to remain at manageable levels, given its market capitalisation, plans for divestment of non-core assets and employee share purchase scheme (ESPS).

The improvement in the credit provisioning levels led to a reduction in the NNPAs. This also improved the solvency levels, which will improve further going forward. The NNPAs are expected to fall below 5.5% by March 2019 and below 4% by March 2020. Meanwhile, the solvency (NNPAs/Net worth) is expected to improve to ~47% by March 31, 2019 and further to ~34% by March 2020 from 89.85% as on September 30, 2018. While estimating the outlook on profitability and capital requirements, ICRA expects slippages to remain below 3% in FY2020. However, in case of higher slippages, capital requirements will be above the estimates mentioned earlier.

The rating continues to be supported by the majority sovereign ownership with the Government of India (GoI) holding 83.09% as on December 31, 2018. The rating is also supported by the BOI's systemic importance as one of the key players in the Indian financial sector, being the fifth-largest public sector bank (PSB), in terms of assets and deposits base. Moreover, the bank's market position is supported by its strong franchise, including a large network of 5,118

[1] *SMA – Special mention accounts; SMA 1 is overdue by 31-60 days and SMA 2 is overdue by 61-90 days*

branches and a comfortable share of domestic current account and savings account (CASA) of 42.65% as on December 31, 2018. This has helped increase the bank's deposit share over the years along with an increase in the retail deposits.

Outlook: Stable

The Stable outlook factors in ICRA's expectations of profitable operations, reduced asset quality pressures and improving solvency levels in FY2020. The outlook will be revised to Positive if the improvement in the bank's asset quality, capitalisation and solvency levels is better than expected, by limiting fresh slippages. The outlook will, however, be revised to Negative in case of weaker-than-expected performance because of higher-than-estimated slippages, leading to weak profitability and deterioration of the capital profile, and if the same is not restored by sufficient capital infusion.

Key rating drivers

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The rating factors in BOI's majority sovereign ownership with the GoI's shareholding at 83.09% as on December 31, 2018 and regular capital infusion from the GoI (Rs. 14,724 crore, Rs. 9,232 crore in FY2018 and Rs. 2,838 crore in FY2017). BOI remains one of the key players in the Indian financial sector, being the fifth-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 5,118 branches as on December 31, 2018. Given BOI's market position and its importance to the Indian financial system, ICRA expects that the GoI will continue to provide capital support, if required. Considering our estimates of capital requirement for FY2020 and BOI's current market capitalisation and divestment of non-core assets, ICRA expects the bank's dependence on the GoI for capital support to be limited in FY2020.

Comfortable capital profile and manageable capital requirement in FY2020 – Upon capital infusion by the GoI in FY2019, BOI's capital profile has improved significantly with the capital ratios getting restored above the regulatory requirement (including CCBs). The capital ratios, i.e., CRAR, Tier I and CET I stood at 12.47%, 9.24% and 9.10%, respectively, against the regulatory requirement of 10.875%, 8.875% and 7.375%, respectively, as on March 31, 2019.

Going forward, in a scenario of 8-9% YoY growth in RWAs, fresh slippages of ~2-3% and provision cover of 76-78%, ICRA estimates BOI's overall equity capital requirement at Rs. 1,250 crore (5% of the current market capitalisation) in FY2020, in order to maintain a capital cushion of 50 bps over the regulatory Tier I of 9.50% as on March 31, 2020. Since the estimated capital requirement is manageable, ICRA expects the bank to be able to raise this capital through multiple channels (QIP, ESPS, etc). Even if the bank is unable to raise the required amount, it can conserve capital consumption by limiting RWA growth or by keeping the provision cover below the ICRA-assumed level stated earlier.

Strong and growing domestic deposit base offsets contracting overseas deposits – As the bank was earlier under the RBI's PCA framework, it consciously curtailed its RWAs by shrinking its overseas operations and conserved capital. In line with this, overseas deposits declined by 9% YoY to Rs. 1,01,679 crore as on December 31, 2018 (Rs. 1,12,037 crore as on December 31, 2017). In contrast, domestic deposits remained stable at Rs. 4,13,499 crore as on December 31, 2018 (Rs. 4,13,966 crore as on December 31, 2017). Domestic CASA deposits remain strong, supported by a robust franchise and an extensive pan-India branch network. The share of domestic CASA continues to inch up and was 42.65% as on December 31, 2018 (40.36% as on December 31, 2017). At an absolute level, domestic CASA was higher by ~6% on a YoY basis at Rs. 1,75,010 crore.

Credit challenges

High slippage rate and credit provisioning; incremental stress expected to reduce going forward – BOI's annualised gross slippage rate in 9M FY2019 was 6.3% (Rs. 14,802 crore) against 11% (Rs. 37,480 crore) in FY2018. Accordingly, its GNPA was very high at 16.32% as on December 31, 2018 compared to 16.60% as on March 31, 2018. Supported by capital infusion and sizeable write-offs, the bank was able to reduce its NNPA to 5.87% as December 31, 2018 from 8.26% as on March 31, 2018. Upon capital infusion from the GoI in Q3 FY2019, BOI upfronted provisioning on its NPAs. As a result, the provision coverage ratio (PCR; excluding TWO) increased to 68.03% as on December 31, 2018 from 57.7% as on September 30, 2018, leading to the highest-ever quarterly loss before tax of Rs. 6,728 crore in Q3 FY2019. With an increased provision cover, the NNPAs declined to Rs. 19,437 crore (5.87%) as on December 31, 2018 from Rs. 28,207 crore (8.26%) as on March 31, 2018.

The management has indicated that the SMA 2 accounts (Rs. 5 crore and above) stood at ~Rs. 6,500 crore, including the sovereign-owned airline exposure of Rs. 3,700 crore apart from agriculture and MSME exposures. In addition, the SMA 1 accounts were also estimated at ~Rs. 6,000 crore as on December 31, 2018. Overall, these SMA exposures accounted for ~4% of the standard advances of the bank as on December 31, 2018 and can be the source of potential stress in future, apart from normal slippages from other accounts. As per ICRA's estimates and factoring in BOI's stressed assets, ICRA estimates that slippages in FY2020 are likely to remain at 2-3% of standard advances in FY2020 and will be lower than the slippages witnessed in FY2019.

Assuming a slippage rate of 2-3% and a provision cover of 76-78% by the end of FY2020, ICRA expects the NPPAs to fall below 4% by March 31, 2020. With lower NPAs and higher net worth (due to improved internal capital generation), ICRA expects the solvency to improve to ~47% as on March 31, 2019 and further to ~34% by March 31, 2020 from 56.7% as on December 31, 2018.

Profitability expected to improve but remain modest in FY2020 – BOI's profitability profile remained weak with the bank reporting a loss before tax of Rs. 9,119 crore in 9M FY2019 against a loss before tax of Rs. 8,633 crore in FY2018 with credit costs surpassing the core operating profitability. The elevated losses were mainly due to the high upfront provisions of Rs. 9,179 crore (6.09% of ATA) in Q3 FY2019, which were taken to reduce the NNPA level to less than 6.0% upon capital infusion by the GoI.

Despite reporting a loss before tax, BOI's operating profit improved to Rs. 5,789 crore (1.28% of ATA) in 9M FY2019 from Rs. 4,495 crore in 9M FY2018 (0.97% of ATA), aided by recoveries from NPA accounts and provision writebacks on the sale of existing NPAs. The improvement in operating profitability was also supported by strong growth in the bank's net interest income (NII), which increased to Rs. 9,613 crore in 9M FY2019 from Rs. 7,943 crore in 9M FY2018. The NII grew on the back of lower income reversals during the period (as fresh slippages declined), NPA recoveries and higher yield on advances as well as stable cost of interest-bearing funds. As a result, net interest margins (NIMs[2]) improved to 2.12% in 9M FY2019 from 1.72% in 9M FY2018.

Going forward, ICRA expects credit costs to moderate to ~0.8-1.2% of net advances (~0.5-0.7% of ATA) in FY2020, which shall be lower than its core operating profits (without treasury income/divestments and credit provisions) of 1.1-1.2% of ATA. With operating profits expected to improve, supported by an increase in earning assets, ICRA expects the bank to report profitable operations in FY2020, even though RoA will remain weak at <0.4-0.5%.

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[2] *NIM = Net interest income/ Average total assets*

Liquidity position

The bank's daily average liquidity coverage ratio remained comfortable at 124% in Q3 FY2019 against the regulatory requirement of 100% as on January 01, 2019, though it was lower than 129% recorded in Q2 FY2019. ICRA expects BOI to maintain satisfactory liquidity, given the steady core deposit base of CASA and retail deposits and considering its sovereign ownership. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity needs.

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 rating factors in BOI's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support BOI with capital infusions, if required
Standalone	For arriving at the rating, ICRA has considered the standalone financials of Bank of India

About the company

Bank of India (BOI) was incorporated in 1906 and was nationalised, along with 13 other banks, in July 1969. The GoI's stake in the bank was 83.09% as on December 31, 2018. As on December 31, 2018, the bank had a widespread network of 5,118 branches and 6,168 ATMs across India. In FY2018, BOI reported a net loss of Rs. 6,044 crore on a total asset base of Rs. 6.04 lakh crore compared to a net loss of Rs. 1,558 crore on a total asset base of Rs. 6.21 lakh crore in FY2017. The bank reported a net loss of Rs. 5,799 crore in 9M FY2019 on a total asset base of Rs. 6.06 lakh crore.

Key financial indicators

	FY2017	FY2018	9M FY2018	9M FY2019
Net interest income	11,826	10,506	7,943	9,613
Profit before tax	-2,373	-8,633	-3,131	-9,119
Profit after tax	-1,558	-6,044	-2,074	-5,799
Net advances	3,66,482	3,41,380	3,50,949	3,31,114
Total assets	6,20,623	6,04,026	6,12,592	6,05,683
% CET I + CCB	7.17%	7.87%	6.62%	9.10%
% Tier I + CCB	8.90%	9.73%	8.82%	9.24%
% CRAR	12.14%	12.94%	12.05%	12.47%
% Net interest margin / Average total assets	1.93%	1.72%	1.72%	2.12%
% Net profit / Average total assets	-0.25%	-0.99%	-0.45%	-1.28%
% Return on net worth	-6.08%	-21.28%	-9.58%	-24.06%
% Gross NPAs	13.22%	16.58%	16.95%	16.32%
% Net NPAs	6.90%	8.26%	10.29%	5.87%
% Provision coverage excl. technical write-offs	51.38%	54.74%	43.79%	68.03%
% Net NPA/ Net worth	94.42%	94.05%	116.65%	56.70%

All ratios as per ICRA calculations
Amount in Rs. crore
Source: Bank, 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							
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	March 2019	FY2019		FY2018		FY2017		FY2016	
						July 2018	Jun 2018	Nov 2017	Jun 2017	Aug 2016	July 2016	Feb 2016	Nov 2015
1	Term Deposits Programme	Medium Term	-	-	MAA+ (stable)	MAA+ (negative)	MAA+ (negative)	MAA+ (negative)	MAA+ (negative); Outlook revised to negative	MAA+ (stable)	MAA+ (stable)	MAA+ (stable); downgraded from MAAA (stable)	MAAA (stable)

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
NA	Term Deposits Programme	-	-	-	-	MAA+(Stable)

Source: Bank of India

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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.

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