September 23, 2022

Central Bank of India: Rating reaffirmed; outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel II Lower Tier II Bonds	500.00	-	[ICRA]A+ (Positive); reaffirmed and withdrawn; outlook revised to Positive from Stable
Basel III Tier II Bonds	2,000.00	2,000.00	[ICRA]A+ (Positive); reaffirmed and outlook revised to Positive from Stable
Total	**2,500.00**	**2,000.00**	

**Instrument details are provided in Annexure I*

Rationale

The revision in the outlook on Central Bank of India's (CBI) long-term rating factors in the continued improvement in the capitalisation and solvency profile[1], which is expected to sustain with the increase in internal capital accruals, driven by the moderation in credit costs. The rating continues to factor in the sovereign ownership with the Government of India's (GoI) shareholding at 93.08% as on June 30, 2022, as well as the demonstrated capital support over the years. This has aided the improvement in the bank's solvency and capitalisation profile to a large extent. Moreover, with the higher provision on legacy stressed assets, the overall net non-performing advances (NNPAs) are on a downward trajectory. Incrementally, CBI's dependence on capital from the GoI could reduce if the improvement in its operational performance sustains. Given the improvement seen so far, the RBI has taken the bank out of the Prompt Corrective Action (PCA) which will be a positive for business growth. Further, the rating continues to factor in CBI's well-established deposit franchise with a strong current account and savings account (CASA) base that also augments its strong liquidity profile, leading to a competitive cost of interest-bearing funds in relation to the public sector banks' (PSB) average.

Despite the relative improvement in the headline asset quality numbers, the overhang of the Covid-19 pandemic on the overall asset quality led to high gross fresh slippages in Q1 FY2023 (annualised fresh NPA generation at 5.2% of standard advances). Moreover, the overall restructured book remained elevated at 4.6% of standard advances as on June 30, 2022 and is higher than the banking system's average. This is in addition to the SMA[2] 1 and SMA 2 book of 5.2% of the standard advances, which is also high. ICRA expects these assets will continue to pose near-term challenges to the asset quality. However, the improved provision coverage ratio (PCR) on legacy stressed assets and recoveries from a relatively large NPA stock will help moderate the credit provisioning requirements on incremental fresh slippages. Going forward, ICRA expects credit costs to remain comparatively lower than the levels seen in recent years.

With the bank turning profitable in FY2022 after several years of losses, ICRA expects the return on assets (RoA) to remain positive going forward. However, in case the slippages are not offset by the targeted recoveries, the RoA and return on equity (RoE) may remain below average.

ICRA has withdrawn the rating assigned to the Rs. 500-crore Basel II Lower Tier II bonds as these bonds have been fully redeemed and no amount is outstanding against the rated instrument. The rating was withdrawn in accordance with ICRA's policy on withdrawal and suspension (click here for the policy).

[1] Solvency profile = Net stressed assets / Core capital; net stressed assets include net NPAs, net non-performing investments (NPIs) and net security receipts (SRs)

[2] SMA or special mention accounts are accounts that are overdue; SMA 1 accounts are overdue by 31-60 days and SMA 2 accounts are overdue by 61-90 days

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The rating continues to factor in the bank's majority sovereign ownership (93.08% equity stake as on June 30, 2022) and the demonstrated track record of capital infusions by the GoI. ICRA also takes into consideration the capital infusion of ~Rs. 21,000 crore during FY2017-FY2021, including capital support of Rs. 4,800 crore in FY2021 by way of zero-coupon bonds (ZCBs)[3]. Given the significant amount of capital received during the aforementioned period, the overall NNPAs could be brought down to a much lower level while improving the overall capitalisation profile. Moreover, the bank may not require further capital in the near term. Further, as a part of the Union Budget, the GoI had proposed the divestment of two PSBs. CBI's rating will be reassessed in case of a change in the sovereign ownership.

Comfortable capital metrics and improving solvency profile – Driven by the capital infusion in FY2021 and the profits generated during the last five quarters, CBI's reported CET I/Tier I (including profits for Q1) and solvency ratios improved to 11.56% and 39.68%, respectively, as on June 30, 2022 from 11.19% and 58.87% respectively, as on June 30, 2021. While the current capital cushions remain adequate with no incremental capital support likely in the near term, capital requirement may arise in FY2024 subject to growth. Nevertheless, the quantum of the same is expected to remain manageable for the bank. This, coupled with the expectation of modest incremental capital generation and growth-led capital consumption, could lead to the erosion of the capital cushions at Tier I over the regulatory requirement of 9.5%.

Well-developed deposit franchise with strong CASA base – CBI has a long-standing presence in the Indian banking system with an extensive network of over 4,528 branches as on June 30, 2022, of which ~64% are in the rural (35%) and semi-urban regions (29%), providing access to low-cost CASA deposits. CBI's share of low-cost CASA stood at 50.3% as on March 31, 2022, which remained meaningfully higher compared to the PSBs' average of 42.4%, thereby translating into a lower cost of interest-bearing funds for the bank. Moreover, the differential in the cost of interest-bearing funds for CBI vis-à-vis the PSBs' average remained flat at 16 basis points (bps) in FY2022 (18 bps in FY2021 and 17 bps in FY2020). Furthermore, the CASA deposits grew by 7.3% YoY to Rs. 1.75 lakh crore as on June 30, 2022, and will remain a source of support for the bank.

Credit challenges

Stressed book remains elevated; asset quality remains a monitorable – The Covid-19-induced stress on the bank's portfolio over the last two years prevented a moderation in the fresh NPA generation level. As a result, the NPA generation rate remained high at 5.2% (annualised) of standard advances in Q1 FY2023 and 4.8% in FY2022 (4.4% in FY2021) although it was comparatively lower than the levels seen during FY2017-FY2020. Furthermore, the headline asset quality metrics were also supported by recoveries and upgrades of Rs. 1,052 crores in Q1 FY2023 (Rs. 7,011 crore in FY2022 and Rs. 3,394 crore in FY2021) and write-offs of Rs. 188 crores in Q1 FY2023 (Rs. 1,265 crore in FY2022 and Rs. 6,087 crore in FY2021). Accordingly, the gross NPA% and net NPA% stood at 14.90% and 3.93% as on June 30, 2022 (14.85% and 3.97% as on March 31, 2022 and 16.56% and 5.77% as on March 31, 2021).

However, despite the elevated slippages, the SMA 1 and SMA 2 advances remain materially high at Rs. 8,557 crore (5.2% of the standard advances), while the standard restructured book stood at Rs. 7,548 crore (4.6%) as on June 30, 2022. As a result, the overall vulnerable book (SMA + standard restructured book) stood at 9.7% as on June 30, 2022 and is yet to decline meaningfully from 11.0% as on March 31, 2021, even while overall slippages remained high. Given the relatively high share of the vulnerable book in relation to the total standard assets and the core capital, its performance as well as the bank's ability to limit slippages will remain a near-to-medium-term monitorable.

[3] *These ZCBs were issued at face value and are redeemable at face value after the 10-15th year from issuance; accordingly, the fair value is lower than the face value. CBI has accounted for these ZCBs at fair value from its March 2022 financials*

While the management has guided towards a slippage rate of 2.2-2.3% for FY2023, ICRA estimates that overall fresh NPA generation could remain higher than the guidance in a stress case scenario, given the sizeable vulnerable book.

CBI has a sizeable pool of NPAs including written-off loans. With the increased PCR on legacy stressed assets and expected recoveries from these assets, ICRA expects that CBI should be able to maintain the NNPAs below 4% while absorbing the credit provisions through core operating profits. However, the extent of recoveries will be a critical driver of the credit costs and eventually the overall profitability.

Profitability and return metrics improve but expected to remain weaker than the industry average – Despite the competitive cost of funds, CBI's core operating profitability (operating profitability excluding gains on bond portfolio) remained low at 1.1% of average total assets in Q1 FY2023 (1.3% in FY2022 and 0.9% in FY2021) compared to the PSBs' average of 1.5% in FY2022 (1.5% in FY2021). The weak core operating profitability was largely due to the low credit-to-deposit ratio of 49% compared to the PSBs' average of 66% as on March 31, 2022, resulting in a suboptimal yield on the assets. This, coupled with the weak asset quality, resulted in the credit costs surpassing the bank's core operating profitability during FY2016-FY2021. The improvement in the operating profitability, along with lower slippages and the higher provision cover on legacy NPAs, helped keep the credit costs lower than the operating profitability during FY2022-Q1 FY2023. This, together with the gains on the bond portfolio, helped the bank turn profitable for the first time in FY2022 after six years. Accordingly, the return on assets (RoA) stood at 0.28% in FY2022 and remained steady at 0.24% in Q1 FY2023.

ICRA expects the bank to remain profitable, though the overall profitability will remain dependent on recoveries from NPAs. The RoA is likely to remain below the PSBs' average of 0.6%. An improvement in the return indicators will remain critical for supporting the growth, while limiting dependence on capital support. This will also remain a positive rating trigger.

Liquidity position: Strong

Given the low credit-to-deposit ratio, CBI's holding of Government securities is relatively higher, which supports its liquidity profile. Accordingly, its liquidity coverage ratio (LCR) stood at 348% in Q1 FY2023 against the regulatory requirement of 100%. This also resulted in positive cumulative mismatches across all the maturity buckets of less than 1 year as on March 31, 2022.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the bank is able to continue improving its internal capital generation with RoA of over 0.3%, while keeping capital cushions of >75 bps over the regulatory Tier I level (including capital conservation buffer; CCB) on a sustained basis.

Negative factors – Given the Positive outlook, the rating is unlikely to be downgraded. However, the rating will be reassessed in case of a change in the sovereign ownership. ICRA could revise the outlook to Stable if the asset quality or capitalisation profile deteriorates, thereby resulting in the weakening of the solvency profile with the solvency becoming weaker than the 70% level on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks ICRA's Policy on Withdrawal of Credit Ratings
Parent/Group support	The rating factors in CBI's sovereign ownership and the demonstrated track record of capital infusions by the GoI. ICRA expects the GoI to support the bank with capital infusions, if required.
Consolidation/Standalone	To arrive at the rating, ICRA has considered the standalone financials of CBI. However, in line with ICRA's limited consolidation approach, the capital requirement of the Group's key subsidiaries, going forward, has been factored in.

About the company

Central Bank of India was incorporated in 1911. It was nationalised in 1969, along with 13 other major banks of India, by the GoI. Headquartered in Mumbai, CBI is a PSB with the GoI holding a stake of 93.08% as on June 30, 2022. CBI is a mid-sized PSB and is the eighth largest, in terms of assets, among PSBs. It had a market share of 1.5% in advances and 2.1% in deposits in the Indian banking sector as on March 31, 2022.

For the year ended March 31, 2022, CBI reported a profit of Rs. 1,045 crore on a total asset base of Rs. 3.83 lakh crore compared to a net loss of Rs. 888 crore on a total asset base of Rs. 3.65 lakh crore for the year ended March 31, 2021. The net profit and total asset base stood at Rs. 235 crore and Rs. 3.87 lakh crore, respectively, as on June 30, 2022. The CRAR stood at 13.33% (Tier I: 11.41%) as on June 30, 2022 (14.81% and 12.82%, respectively, as on March 31, 2021).

Key financial indicators (standalone)

Central Bank of India	FY2021	FY2022	Q1 FY2022	Q1 FY2023
Net interest income	8,245	9,487	2,127	2,142
Profit before tax	(1,324)	1,717	622	308
Profit after tax	(888)	1,045	206	235
Net advances (Rs. lakh crore)	1.57	1.68	1.55	1.72
Total assets (Rs. lakh crore)	3.65	3.83	3.68	3.87
CET I	12.82%	11.48%	11.06%*	11.41%*
Tier I	12.82%	11.48%	11.06%*	11.41%*
CRAR	14.81%	13.84%	13.01%*	13.33%*
Net interest margin / ATA	2.29%	2.54%	2.32%	2.23%
PAT / ATA	-0.25%	0.28%	0.22%	0.24%
Return on net worth	-3.91%	4.39%	3.60%	3.92%
Gross NPAs	16.56%	14.85%	15.93%	14.90%
Net NPAs	5.77%	3.97%	5.09%	3.93%
Provision coverage excl. technical write-offs	69.1%	76.2%	71.7%	76.7%
Net NPA / Core equity capital	47.3%	39.2%	46.8%	39.0%

*Source: Central Bank of India, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore unless mentioned otherwise; * Excludes Q1 profits*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 16, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Sep 23, 2022	Sep-30-21	Oct-23-20	Sep-26-19
1	Basel II Lower Tier II Bonds	Long Term	500	-	[ICRA]A+ (Positive); withdrawn	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
2	Basel III Tier II Bonds	Long Term	2,000	500^	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)

^ *Balance amount yet to be placed*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Basel III Tier II Bonds	Highly Complex
Basel II Lower Tier II Bonds	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

<table>
<tr><th>ISIN</th><th>Instrument Name</th><th>Date of Issuance</th><th>Coupon Rate</th><th>Maturity</th><th>Amount Rated (Rs. crore)</th><th>Current Rating and Outlook</th></tr>
<tr><td>INE483A09245</td><td>Basel II Lower Tier II Bonds</td><td>Dec-21-11</td><td>9.33%</td><td>Dec-21-21</td><td>500</td><td>[ICRA]A+ (Positive); withdrawn</td></tr>
<tr><td>INE483A08023</td><td rowspan="2">Basel III Tier II Bonds</td><td>Sep-30-19</td><td>9.80%</td><td>Nov-30-29^</td><td>500</td><td rowspan="2">[ICRA]A+ (Positive)</td></tr>
<tr><td>Unplaced</td><td>-</td><td>-</td><td>-</td><td>1500</td></tr>
</table>

^ With first call option after 62 months of issuance

Source: Central Bank of India

Key features of rated debt instruments

The servicing of the Basel III Tier II Bonds is not subject to any capital ratios and profitability. However, these bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked by the Reserve Bank of India (RBI). The Basel III Tier II Bonds have equity-like loss-absorption features. Such features may translate into higher loss severity vis-à-vis conventional debt instruments.

Annexure II: List of entities considered for limited consolidated analysis

Company Name	Ownership	Consolidation Approach
Cent Bank Home Finance Limited	64.40%	Limited Consolidation
Centbank Financial Services Limited	100.00%	Limited Consolidation
Uttar Bihar Gramin Bank, Muzaffarpur	35.00%	Limited Consolidation
Uttarbanga Kshetriya Gramin Bank	35.00%	Limited Consolidation
Indo Zambia Bank Limited	20.00%	Limited Consolidation

Source: Central Bank of India

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Aashay Choksey
+91 22 6114 3430
aashay.choksey@icraindia.com

Devesh Lakhotia
+91 22 6114 3404
devesh.lakhotia@icraindia.com

Gayatri Kulkarni
+91 22 6114 3471
gayatri.kulkarni@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches