India Ratings Revises Outlook on Central Bank of India's Basel III Tier-II Bonds to Positive; Affirms 'IND AA-'

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India Ratings and Research (Ind-Ra) has revised the Outlook on Central Bank of India's (CBOI) Basel III Tier-II bonds to Positive from Stable while affirming the rating at 'IND AA-' as follows:

Instrument Type	Date of Issuance	ISIN	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier-II bonds*	20 March 2020	INE483A08031	9.20	20 May 2030	INR15	IND AA-/Positive	Affirmed; Outlook revised to Positive

*INR10 billion unutilised

Analytical Approach: Ind-Ra continues to factor in the support available from the government of India (GoI) to arrive at the ratings. The GoI's 93.08% stake in CBOI at end-September 2023 indicates the bank's systemic importance to the government.

The Outlook revision reflects the bank's improving capital position and operating buffers, indicating its increasing ability to maintain its market share and absorb the impact of expected and unexpected credit costs. The Positive Outlook also reflects the drastic reduction of adverse provisioning impact of legacy non-performing assets (NPAs) on CBOI and overall improvement in the lending environment especially for banks. These factors, in the agency's opinion, could boost CBOI 's profitability in medium term and grow its share in advances and deposits over the medium term.

Key Rating Drivers

Strengthened Capital Buffers: CBOI's capital buffers have improved over the 10 quarters ended 2QFY24 and the bank is now better placed than historically, as reflected in the common equity tier I (CET-I) ratio and tier-I capital adequacy ratio of 12.14% and 14.82%, respectively, at end-2QFY24 (FYE21:10.79%, 12.48%). This also needs to be viewed in context of the bank's net NPAs being reduced to about 1.64% at end-2QFY24 from 5.77% at end-FY21. Also, CBOI's risk weighted assets to net advances decreased to 78.0% at end-2QFY24 (FY21: 94.6%), largely because of better capital efficiency led by lending to better rated corporates. Ind-Ra believes the manageable asset quality would enable the bank to maintain material profitability compared to its previous performance though FY24-FY25. Ind-Ra believes the existing capital buffers are adequately placed to also absorb asset quality shocks.

After factoring in the elevated provisioning requirements in FY24, on account of potential slippages, the agency believes CBOI's capital buffers will be adequate for growth requirements. Furthermore, with a sharp rise in provisions coverage ratio over FY18-FY23, the need to provide for legacy NPAs has been taken care of, which reduces the pressure on profitability. Additionally, with the bank returning to sustainable profitability, internal accruals shall add to the capital buffers. Ind-Ra also believes that the impact of RBI's recent circular on increasing risk weight requirements for unsecured consumer credit and for lending to the non-bank segment is going to be 30-40bp on CET 1 and easily absorbable, given its capital buffers.

Profitability on Improving Trend: CBOI's profit increased significantly to about INR10.2 billion in 1HFY24 (FY23: INR15.82 billion; FY22: INR10.45 billion), mainly backed by a decline in its credit costs, growth in advances and improved net interest margins of 3.43% in 2QFY24 (FY21: 2.78%). The later was led by faster repricing in advances than in deposits and a strong current and savings account (CASA) profile. The bank's credit cost (provision for NPA to average net advances) was 2.3% in FY23 (FY22: 2.1%, FY21: 3.9%). Ind-Ra expects the bank to witness a credit cost of about 2% over the near-to-medium term which will be absorbed by its expected steady-state operating profit (pre-provisioning operating profit to net advances: 1HFY24: 3.32%, FY23: 4.09%); thus, Ind-Ra does not expect the bank to make losses on account of credit costs as witnessed in the past.

Improved Liability Franchise: CBOI has a strong liability franchise with a CASA ratio of 49.2% in 2QFY24, which has helped it maintain net interest margin of around 3%. The overall deposits grew 8.2% yoy in 2QFY24, with the CASA growing at 4.9% yoy. The low cost of deposits and the bank's increasing CASA were aided by the FY15-FY20 advances CAGR decline of 4.3%, which also helped bank to accrue a sticky and granular deposit profile.

Liquidity Indicator – Adequate: CBOI maintained a surplus funding of about 6.2% in the cumulative one-year bucket as a percentage of total assets in 2QFY24. The bank also maintained about 30.6% of the total assets as balances with the Reserve Bank of India and government securities, which gives Ind-Ra the comfort that CBOI is well placed to meet its short-term funding requirements. CBOI also had a comfortable liquidity coverage ratio of 236.58% in 2QFY24 (2QFY23: 288.01%), significantly above the regulatory requirement of 100%. If the deposit growth does not keep pace with advances growth, then the bank may need to increasingly rely on wholesale sources, which could affect liquidity. However, this seems manageable in the foreseeable future.

Asset Quality Improving, But Yet to Stabilise: The bank's gross non-performing asset (GNPA) ratio declined to 4.62% in 1HFY24 (FY23: 8.44%, FY22: 14.84%) mainly on account of huge write-offs of INR99.3 billion which were modestly higher than peers'. While the bank's provision cover (net of technical write offs) of about 65.65% at end-2QFY24 (FY23: 80.47%, FY22: 76.29%) and the net NPA levels at about 1.64% (1.77%, 3.97%) are weaker than that of peers, CBOI intends to lower its net NPA to below 1% and increase provision coverage ratio (net of technical write-offs) to 75% by end-FY24. Hence, Ind-Ra opines the bank might have to take up more provisions, and may be in a position to cover the gap only by next year.

Furthermore, CBOI had about 1.9% loans as a percentage of net advances at end- 2QFY24 (FYE23: 2.35%; FY22: 3.89%) that were restructured under the COVID-19 resolution framework and loans worth about INR27.16 billion that have been, in the agency's opinion, supported by the Emergency Credit Line Guarantee Scheme. Also, CBOI witnessed a gross slippage of about 1.7% (not annualised) in 1HFY24 (FY23: 2.1%; FY22: 2.7%) and net slippage (gross slippage less upgrades and recoveries) of 1.0% (0.26%, 0.06%). 1HFY24 also incorporates 100% provisioning on an airline account which slipped to GNPA in 1HFY24. The gross slippage ratio and net slippage ratio excluding the airline account for 1HFY24 was 0.8% and 0.13% (not annualised), respectively. Ind-Ra believes the bank may not see significant net slippages in FY24 and the asset quality is likely to continue to improve and would be manageable over the near-to-medium term.

Rating Sensitivities

Positive: Sustained systemic importance reflected in the bank's improving market share in advances and deposits could lead to a positive rating action. A consistent improvement in the bank's standalone capital and profitability buffers (with increased profitability from the core lending operations), while maintaining peer-comparable asset quality or better, and an overall improvement in the operating environment could also lead to a positive rating action.

Negative: The Basel III Tier-2 bond rating are based on Ind-Ra’s expectation of continuous support from the GoI (majority shareholder) to meet the minimum capital requirements. Any change in the majority GoI ownership or a change in the agency’s opinion regarding the GoI’s timely support for the bank, which could be warranted in case of a sharp drop in capitalisation or otherwise, could result in a negative rating action or a rating watch. Also, sustained deterioration in the operating performance and continuing pressure on the asset quality could lead to a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on CBOI, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra’s ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

CBOI has a significant presence in rural and semi-urban areas, with about 65% of its branches located in these regions. At 2QFYE24, it had 4,489 branches and 4,044 ATMs in India.

FINANCIAL SUMMARY

Particulars	FY23	FY22
Total assets (INR billion)	4,061.6	3,865.7
Total equity (INR billion)	291.1	275.3
Net income/loss (INR billion)	15.8	10.4
Return on average assets (%)	0.40	0.28
Equity/assets (%)	7.2	7.1
Capital adequacy ratio (%)	14.12	13.84
Source: CBOI, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	12 December 2022	13 December 2021	3 March 2021
Basel III Tier-II bonds	Long-term	INR15	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Negative

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Basel III Tier-II bonds	Moderate

For details on the complexity level of the instrument, please visit https://www.indiaratings.co.in/complexity-indicators.

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The Rating Process

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