September 19, 2019

Central Bank of India: Ratings reaffirmed; Removed from Rating Watch with Developing Implications; Negative outlook assigned on the Upper Tier II bonds

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Lower Tier II bonds programme	500.00	500.00	[ICRA]A+(negative); reaffirmed
Upper Tier II bonds programme	285.00	285.00	[ICRA]A- reaffirmed; 'rating watch with developing implications' removed and 'negative' outlook assigned
Upper Tier II bonds programme	500.00	500.00	[ICRA]A- reaffirmed; 'rating watch with developing implications' removed and 'negative' outlook assigned
Upper Tier II bonds programme	500.00	500.00	[ICRA]A- reaffirmed; 'rating watch with developing implications' removed and 'negative' outlook assigned
Upper Tier II bonds programme	1,000.00	1,000.00	[ICRA]A- reaffirmed; 'rating watch with developing implications' removed and 'negative' outlook assigned
Total	**2,785.00**	**2,785.00**	

**Instrument details are provided in Annexure-1*

Rationale

The removal of the rating watch on the Basel II compliant upper Tier II[1] bonds takes into account the sizeable capital infusion by the Government of India (GoI) in Central Bank of India (CBI). The GoI infused equity capital of Rs. 6,588 crore in FY2019 and proposes to infuse Rs. 3,300 crore in FY2020. Further, the ratings are supported by the majority sovereign ownership of CBI, with the GoI's holding 91.20% as on June 30, 2019. With the capital infusion in FY2019 and FY2020, ICRA expects CBI to meet the regulatory capital ratios in FY2020, thereby reducing the risks linked to the servicing of its debt capital instruments.

The Negative outlook continues to be driven by the bank's weak asset quality, with fresh slippages of 7.4% of standard assets in FY2019 compared to 8.4% in FY2018, and above the public sector bank (PSB) average of 4.7% in FY2019. Further, CBI's annualised rate of NPA formation remained high in Q1 FY2020 at 6.61%. Accordingly, the gross non-performing assets (GNPAs) and net NPAs (NNPAs) stood at significantly high levels of 19.31% and 7.73%, respectively, as on March 31, 2019 (21.51% and 11.10%, respectively, as on March 31, 2018) and increased to 19.95% and 7.98% as on June 30, 2019, respectively. Accordingly, the credit provisions remained elevated at 3.3% of average total assets (ATA) in FY2019 compared to 3.4% in FY2018, thereby translating into a net loss, with Net Loss/ATA of -1.73% in FY2019 compared to -1.56% in FY2018.

[1] *Innovative perpetual debt instruments (IPDIs) and upper Tier II bonds – in a year of loss, the capital instruments can be serviced with prior approval from the RBI subject to the bank meeting the minimum regulatory capital ratios (Tier I of 7.0% and CRAR of 9.0%)*

Even though the slippages remained at elevated levels in Q1 FY2020, the credit costs were lower at 1.10% of ATA. However, going forward, ICRA expects the credit costs to remain high in FY2020 as the bank will need to increase provisioning on its NPAs to exit the prompt corrective action (PCA) framework of the Reserve Bank of India (RBI). The high level of NNPAs also translated into a weak solvency profile with NNPA/core equity at 104% as on March 31, 2019, despite the sizeable capital support in FY2019, and remained at a similar level of 104% as on June 30, 2019.

Going forward, ICRA estimates the pace of fresh NPA generation to remain elevated at ~5-6% of standard advances in FY2020, which is expected to be lower than the rate of NPA generation witnessed in FY2019. ICRA also expects the bank to reduce the NNPA levels to less than 6% as on March 31, 2020, supported to a large extent by the capital support in FY2020, which will translate into elevated credit provisions and net losses in FY2020. As per ICRA's estimates, credit provisions, at 1.3-1.50% of ATA, will remain significantly above the bank's overall core profitability in FY2020 and will lead to net losses.

However, despite losses, ICRA expects the bank to maintain the regulatory capital ratios (CRAR of 9.0%) due to the recent announcement of capital infusion of Rs. 3,300 crore in FY2020 by the GoI. While CBI is likely to maintain a CRAR of 9.0%, maintaining the capital conservation buffers (CCBs) while reducing the NNPAs to <6% may remain a challenge unless supported by a significant reduction in risk weighted assets (RWAs) or sizeable recoveries or further capital infusion in FY2020.

As a step towards exiting the PCA framework, CBI has approved an equity capital raise of up to Rs. 5,000 crore for FY2020, a part of which is already proposed to be infused by the GoI. Based on this, ICRA expects the bank's capital requirement in FY2020 to remain relatively manageable at Rs. 1,100-1,400 crore (13-17% of market capitalisation) for FY2020, assuming a 50 bps cushion over the regulatory Tier I ratios including CCBs while reducing the NNPAs to <6%.

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated funding support – The ratings continue to factor in the bank's majority sovereign ownership (91.20% held by the GoI as on June 30, 2019) and demonstrated capital infusion from the parent (Rs. 6,592 crore in FY2019 and Rs. 3,300 crore for FY2020) to support the capitalisation position. Although the bank witnessed capital erosion in FY2019 due to losses on account of weak asset quality, the timely capital support from the GoI in FY2019 helped to contain a further weakening of the bank's capital position. Moreover, CBI raised Rs. 213 crore through an employee stock purchase scheme (ESPS), which supported its capitalisation. Going forward, the capital infusion of Rs. 3,300 crore is expected to meet a majority of the capital requirement in FY2020, though this is subject to further weakening of the asset quality and continued degrowth of the book.

Well-developed deposit franchise with strong CASA base – CBI has an extensive network of over 4,659 branches, of which ~63% are in the rural and semi-urban region, providing access to low current and savings account (CASA) as on March 31, 2019. The bank had a strong CASA base of 46.21%[2] as on March 31, 2019, significantly above the PSB average of ~39%. CBI's CASA remained steady at 45.45% as on June 30, 2019 while the PSB average remained at ~38-39% as on June 30, 2019. Although the overall branch network remained stable, excluding a few branches that were closed to contain costs by rationalising relatively inefficient branches, CASA mobilisation continued to grow in FY2019 to Rs. 1,38,555 crore from Rs. 1,25,196 crore as on March 31, 2018. Accordingly, the cost of interest-bearing funds declined to 5.24% in FY2019 from 5.78% in FY2018.

[2] *Calculated as CASA/Total Domestic Deposits*

Credit challenges

Weak asset quality; incremental slippages likely to remain high in FY2020 – The overall stock of GNPAs remained high in FY2019 due to high slippages amounting to Rs. 10,460 crore. While the slippages were offset by recoveries and upgradations of Rs. 5,680 crore, apart from write-offs of Rs. 10,375 crore, leading to a decline in GNPAs, the bank's asset quality indicators remained weak with GNPAs of Rs. 32,356 crore (GNPA/Gross Advances of 19.31%) and NNPAs of Rs. 11,333 crore (NNPA/Net Advances of 7.73%) as on March 31, 2019. Moreover, a large stock of unprovided NPAs, coupled with weak capitalisation, kept the solvency indicators weak with NNPA/Core Equity at 104% as on March 31, 2019. The asset quality remained weak in Q1 FY2020, with slippages of Rs. 2,233 crore, although write-offs and upgrades offset the increase resulting in a marginal addition to the GNPA stock as on June 30, 2019. The GNPA and NNPA levels inched up to 19.95% and 7.98% as on June 30, 2019, respectively. With a proposed capital infusion of Rs. 3,300 crore for FY2020, ICRA expects the bank's solvency to improve by March 2020, with expected Net NPA/CET of ~65%.

In addition to this, CBI has sizeable special mention account-1 & 2 (SMA-1 & SMA-2) exposures at ~11.85%[3] of the standard advances as on June 30, 2019 (including exposures below Rs. 5 crore). Accordingly, ICRA expects fresh NPA formation to remain high at ~5-6% of standard advances in FY2020, although this would be below the elevated level of 7.4% in FY2019. This, coupled with the bank's intention of exiting the PCA, is likely to translate into credit costs of ~1.3-1.5% of assets in FY2020, down from 3.3% in FY2019. To exit the PCA, the bank will need to bring down the NNPA levels to less than 6%. CBI is expected to increase its overall provision coverage ratio to 77-78% in FY2020 from 65%[4] as on March 31, 2019. While this will keep the bank dependent on capital support in addition to the amount already announced by the GoI, efforts to contain the NNPA levels within 6% will improve its prospects of being placed outside the PCA framework.

Despite lower slippages, profitability and return metrics to remain weak – The net interest margin (NIM), as a percentage of ATA, remained modest at 2.08% in FY2019 (against the PSB average of 2.33%). However, the core profit before tax (PBT after provisions) continued to be impacted by the high credit costs of 3.3% for FY2019 on account of high slippages. As a result, core PBT/ATA remained weak at -2.46% in FY2019. Accordingly, CBI's pre-tax loss stood at Rs. 8,170 crore in FY2019, higher than the loss of Rs. 7,896 crore in FY2018. Going forward, ICRA expects the internal capital generation to remain weak in FY2020, given the above-mentioned slippages and credit provisions, with only meaningful recoveries remaining key for shoring up profitability. ICRA expects the bank's RoA to remain weak at losses of (0.3)-(0.4)% of ATA.

Capitalisation remains weak; capital requirement at manageable levels for FY2020 – CBI reported a net loss of Rs. 5,641 crore in FY2019 compared to a net loss of Rs. 5,105 crore in FY2018. Capital erosion during the last four years led to a sharp weakening in the bank's capitalisation profile. However, with the GoI extending support by infusing Rs. 6,592 crore in FY2019, the bank's capital ratios were prevented from slipping further and its regulatory capital adequacy stood at 9.61% (Tier I of 7.49% and CET I of 7.49%). Under Basel III norms, the minimum regulatory requirement, including CCB of 1.875%, was CRAR of 10.875%, Tier I of 8.875% and CET I of 7.375% as on March 31, 2019. Further, the capital ratios were supported by Rs. 213 crore raised under the bank's ESPS in Q4 FY2019. Despite these efforts, CBI's overall capital position remains weak. The planned infusion of Rs. 3,300 crore in FY2020 will support the bank in its efforts to meet the regulatory levels as on March 31, 2020.

Post the announced infusion, ICRA expects CBI's capital requirement in FY2020 to remain relatively manageable at Rs. 1,100-1,400 crore (13-17% of market capitalisation) for FY2020, assuming a 50 bps cushion over the regulatory Tier I ratios, including CCB, while reducing the NNPAs to <6%. Meanwhile, CBI has approved an equity capital raise of up to Rs.

[3] Including exposures below Rs. 5 crore

[4] Excluding technical write-offs

5,000 crore for FY2020 (including the amount infused so far – Rs. 3,300 crore), though the extent of capital requirement will remain linked to recoveries, which will also be instrumental in influencing investor appetite.

Liquidity position: Strong

The bank's daily average liquidity coverage ratio (LCR) remained comfortable at 280% in FY2019 (253% in FY2018) against the regulatory requirement of 100%. Further, the LCR was reported at 340% for Q1 FY2020 against 295% for Q4 FY2019 and 247% for Q1 FY2019. Moreover, the statutory liquidity ratio (SLR) stood at 32% of the net demand and time liabilities as on March 31, 2019, above the regulatory requirement of 19%. As per the structural liquidity statement for May 15, 2019, the bank had positive cumulative mismatches across all buckets up to 1 year. ICRA expects CBI to maintain strong liquidity, though this will depend on its ability to retain its deposit base. 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.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Stable and/or upgrade the rating if the bank's solvency level improves with Net NPA/CET of <60%, while the NNPAs are maintained below 6% and the capital ratios are above the regulatory level on a sustained basis.

Negative triggers – ICRA could downgrade the ratings in case of insufficient capital support from the GoI, leading to sustained capital breaches with CRAR of <9.0%, which is critical for servicing the rated debt capital instruments.

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[5]	The ratings factor in CBI's direct sovereign ownership and demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support CBI with capital infusions.
Standalone	For arriving at the ratings, ICRA has considered the standalone financials of CBI.

About the company

Headquartered in Mumbai, Central Bank of India is a public sector bank with the GoI holding a stake of 91.20% as on June 30, 2019. For the year ended March 31, 2019, CBI reported a loss after tax of Rs. 5,641 crore on a total asset base of Rs. 3.28 lakh crore compared to a loss after tax of Rs. 5,105 crore on a total asset base of Rs. 3.23 lakh crore for the year ended March 31, 2018. It reported a net profit of Rs. 118 crore in Q1 FY2020 compared to a net loss of Rs. 1,522 crore in Q1 FY2019. As on June 30, 2019, the bank reported capital adequacy under Basel III of 9.58% (Tier 1: 7.58%), GNPA of 19.95% and NNPA of 7.98%.

[5] *Shareholding as on June 30, 2019*

Key financial indicators (audited)

Particulars	FY2018	FY2019	Q1 FY2019	Q1 FY2020
Net interest income	6,517	6,772	1,678	1,790
Profit before tax	-7,896	-8,170	-2,385	70
Profit after tax	-5,105	-5,641	-1,522	118
Net advances	1,56,542	1,46,525	1,52,064	1,43,454
Total assets	3,23,095	3,27,377	3,21,955	3,26,785
% CET I+ CCB	7.01%	7.49%	6.05%	7.58%
% Tier 1	7.01%	7.49%	6.05%	7.58%
% CRAR	9.04%	9.61%	8.05%	9.58%
% Net interest margin/ATA	2.00%	2.08%	2.08%	2.19%
% Net profit/ATA	-1.56%	-1.73%	-1.89%	0.14%
% Return on net worth	-34.50%	-36.79%	-43.20%	2.93%
% Gross NPAs	21.51%	19.31%	22.19%	19.95%
% Net NPAs	11.10%	7.73%	10.58%	7.98%
% PCR without TWO	54.43%	64.97%	58.52%	65.24%
% Net NPA/CET	139%	104%	159%	104%

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 past three years

Sr. No.	Name of Instrument	Current Rating FY2020 Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	19-September 2019	Chronology of Rating History for the Past 3 Years FY2019 30-Nov-18	7-Aug-18	7-May-18	FY2018 8-Aug-17	FY2017 7-Mar-17	FY2016 22-Feb-16
1	Lower Tier II bonds programme	Long Term	500	500	[ICRA] A+ (negative))	[ICRA] A+ (negative))	[ICRA] A+ (negative))	[ICRA] A+ (negative))	[ICRA] A+ (negative))	[ICRA] A+ (negative)	[ICRA] AA- (negative)
2	Upper Tier II bonds programme	Long Term	285	285	[ICRA] A- (negative)	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
3	Upper Tier II bonds programme	Long Term	500	500	[ICRA] A- (negative)	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
4	Upper Tier II bonds programme	Long Term	500	500	[ICRA] A- (negative)	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)
5	Upper Tier II bonds programme	Long Term	1000	1000	[ICRA] A- (negative)	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (negative)	[ICRA] A- (negative)	[ICRA] A (negative)	[ICRA] A+ (negative)

& Under Watch with Developing Implication

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE483A09245	Lower Tier II bonds	21-Dec-2011	9.33% p.a.	21-Dec-2026	500.00	[ICRA]A+ (negative)
INE483A09195^	Upper Tier II bonds	17-Feb-2009	9.40% p.a. Step up of 50 bps from 11th year (9.90% till maturity)	17-Feb-2024	285.00	[ICRA] A- (negative)
INE483A09203^	Upper Tier II bonds	23-June-2009	8.80% p.a. Step up of 50 bps from 11th year (9.30% till maturity)	23-June-2024	500.00	[ICRA] A- (negative)
INE483A09211	Upper Tier II bonds	20-Jan-2010	8.63% p.a. Step up of 50 bps from 11th year (9.13% till maturity)	20-Jan-2025	500.00	[ICRA] A- (negative)
INE483A09229	Upper Tier II bonds	11-June-2010	8.57% p.a. Step up of 50 bps from 11th year (9.07% till maturity)	11-June-2025	1,000.00	[ICRA] A- (negative)

These instruments have been redeemed by exercise of call option by the bank and will be withdrawn in due course
Source: Central Bank of India

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