
Rating Rationale for Bank of Baroda's Upper Tier II Bonds Rating

Brickwork Ratings assigns “BWR AAA+” for Bank of Baroda's Upper Tier II Bonds Issue of INR 10 billion

Issue Rating: BWR AAA+

Outlook: Stable

Brickwork Ratings has assigned BWR AAA+ (Pronounced BWR Triple A Plus) for Bank of Baroda's proposed Upper Tier II Capital Bonds issue of INR 1000 crore or INR 10.00 billion. Brickwork ratings' 'BWR AAA+' stands for an instrument that is considered to offer the BEST credit quality in terms of timely serving of debt obligations. The rating factored higher operating profits, improving asset quality, well diversified credit deployment, comfortable capital adequacy & low cost deposits, healthy earning assets, profitable overseas operation, and the Government of India's equity stake.

The continuing financial crises in the domestic market and prevailing economic slowdown in the international markets did not have highly adverse impact on Bank of Baroda operating performance. As a result, the bank has posted robust growth in total business, deposits and advances along with improving non-performing assets during FY 09. With total global business growth of 30.00%, the bank was able to overcome the tough economic conditions prevailed during FY 09. Similarly, the bank's global gross advances and deposits grew by 34.90% and 26.60% respectively during FY 09.

The bank's asset quality seems to be sound and consistent compared to its peer group. During FY 09, the bank's gross NPAs stood at 1.27%, about 66 bps lower than that of peers' 1.93%. Similarly, the bank's net NPAs at 0.31%, 35 bps lower than the peers' average of 0.66%. Further, the bank's overseas business gross NPAs and net NPAs stood at 0.51% and 0.04% respectively during the year.

During FY 09, the bank's low cost deposits mix was stable, with its domestic CASA deposits at 34.87%, which is 217 bps higher than its peer's average of 32.70%, mainly driven by the bank's aggressive savings and current account marketing during the year and also branch expansion in rural and semi urban areas. However, the bank's global CASA deposits decreased from 31.22% in FY08 to 29.59% in FY 09.

The bank has comfortable capital adequacy ratio at 14.05% under Basel II norms during the year, which is significantly higher than its peers' average of 13.51%. Similarly, the bank's Tier I capital stood at 8.49%, which is 13 bps higher than that of peers. Overall, the rating factored the bank's Government of India ownership, improved earning assets quality, comfortable domestic CASA deposits, profitable overseas operation, adequate risk management system, and healthy capital adequacy ratio.

Table I: Bank of Baroda's Improving Strengths

Criteria	FY 09	FY 08	FY 07
Total Assets IINR Billion)	2274.06	1759.99	1431.46
Deposits (INR Billion)	1923.96	1520.34	1249.15
Advances (INR Billion)	1439.85	1067.01	836.20
Non-Performing Assets			
Gross NPAs	1.27%	1.84%	2.47%
Net NPAs	0.31%	0.47%	0.60%
Profit			
Gross Profit (INR Billion)	43.05	29.29	24.15
Net Profit (INR Billion)	22.27	14.36	10.26
ROA	1.15%	0.89%	0.80%
ROE	19.56%	15.07%	12.17%
CRAR	14.05%	12.91%	11.80
Tier I	8.49%	7.63%	8.74%
Branches	2,926	2,853	2,782
ATMs	1,179	1,106	1,000

The bank has performed really well despite the fact that financial year 2009 has witnessed many challenges of financial crises in the domestic as well as overseas. Bank of Baroda however managed to maintain its growth momentum and overall progress achieved in the recent past. The bank's **global business** had increased by 30.00% (as against 24.07% in FY08) during FY 09 to reach INR 3363.82 billion from INR 2587.35 billion for the same period in 2008.

Bank of Baroda is one of the largest public sector banks with a reported **asset base** of INR 2,274.06 billion and **off-balance sheet exposure** of INR 733.86 billion as on 31st

March 2009. The bank has progressively grown its asset base over the years, aided by strong growth in deposits and advances. As a result, the bank has achieved a 26.62% growth in total assets during FY09.

The bank's **global deposits** stood at INR 1923.96 billion, a growth of 26.54% as on 31st March 2009, compared to INR 1520.34 billion, a year ago. In line with public sector banks in India, the bank is also mostly funded through term deposits. The term deposits of Bank of Baroda account for 70.40% of total deposits. Further, the bank has reduced its dependence on bulk deposits from 24.00% to 16.90% during the year.

The bank's **gross advances** increased by 34.90% to reach INR 1439.85 billion in FY09 from the previous level of INR 1067.01 billion. While advances have grown robustly, the bank's term lending component at 43.90% (FY09) is significantly lower than the previous year figure of 46.47%. During FY09, the bank has posted an impressive retail credit growth of 16.3% to reach INR 196.51 billion and formed 17.9% of total gross domestic credit. Similarly, the bank's farm credit surged by 27.9% to INR 169.64 billion and its SME loan-book stood at INR 146.62 billion with a growth rate of 24.2%.

During FY 09, the bank's secured loan portfolio significantly increased by 40.15%, while the unsecured lending has increased only by 20.29%. In spite of increase in unsecured lending, the bank's credit profile does not pose a serious threat as they only account for 23.40% (26.25% in FY08) of the bank's total outstanding credit as on 31st March 2009.

Over the years, the bank's **asset quality** has been improving through the bank's relatively better credit culture and monitoring. As a result, the bank's gross NPAs have come down to 1.27% as on 31st March 2009 from 1.84% for the same period a year ago. The bank's net NPAs have shown a similar trend, which has declined to 0.31% in FY09 from 0.47% in FY08. The declining trend in the non-performing assets has been witnessed not only in the percentage terms, but also in absolute level. The bank's gross NPAs stood at INR 18.42 billion during FY09 as compared to INR 19.81 billion during FY08. The sustained improvement in the bank's asset quality is commendable despite strong loan growth witnessed during the year.

The bank has been very consistent in generating profit over the years. Despite a noticeable deterioration in credit growth in the banking industry during FY 09, the bank

posted excellent revenues and profit figures. With total income of INR 178.49 billion during FY 09 (as against INR 138.64 billion in FY 08), reflecting the significant improvement in core banking operations, and improved fee based activities. In addition, the bank has focused on building healthy earning assets, which contributed to improvement in the profitability. The non-interest income of the bank increased from INR 20.51 billion to INR 27.57 billion, registering an increase of 34.45%, which is favorably comparable to its peers.

The bank's **net interest income** has registered an impressive growth rate of 31.00% to reach INR 51.23 billion during FY09. Further, the bank had witnessed strong growth (43.00%) in net interest income during Q4 FY 09 in spite of reduction in prime lending rate by 150 bps between November-January 2008-09 in response to the monetary policy signals.

Table II: Bank of Baroda Financials

Financials (INR Billion)	2008-09	2007-08
Interest Income	150.91	118.13
Interest Expenses	99.68	79.01
Net Interest Income	51.23	39.12
Non-interest Income	27.57	20.51
Operating Income	78.8	59.63
Employee Expenses	23.48	19.04
Other Operating Expenses	12.27	11.31
Operating Profits	43.05	29.28
Provisions & Contingencies	20.78	14.93
Profit After Tax	22.27	14.35

During FY09, the bank's net profit also increased to INR 22.27 billion from INR 14.35 billion during FY 08, with an impressive growth of 55.14%. The bank continued to improve profitability, which is largely driven by robust growth in the core banking operations, optimum operating cost structure, healthy earning assets and growth in non-interest income.

The bank has well designed internal capital adequacy assessment policy to comprehensively evaluate capital adequacy requirements. The bank registered total **capital adequacy ratio** of 14.05% under Basel II as on 31st March 2009 compared to

12.91% (under Basel I) for the same period a year ago. Further, the bank's tier-I capital ratio has significantly increased to 8.49% from the previous year figure of 7.63%.

During FY 09, the bank's **Return on Assets (ROA)** had improved to 1.15% as compared to 0.89% in FY08. Similarly, the bank's **Return on Equity (ROE)** stood at 19.56% as on 31st March 2009 as against 15.07%.

Since 1956, the bank has been growing its **overseas business** progressively covering different regions and major financial markets around the world. During FY 09, the bank has strengthened its overseas operations by opening of 4 new offices and extended its presence to 25 countries. As of 31st March 2009, the bank has 74 overseas offices.

Table III: Bank of Baroda Overseas Operations

Financials (INR Billion)	2008-09	2007-08
Deposits	409.88	295.54
Advances	347.03	221.98
Gross NPAs	0.51%	0.55%

The bank's overseas operation includes rising of resources from international markets, loan syndications, arranging of funds, and acquisition finance. During FY09, the bank's international operations have contributed 22.50% of the total business despite economic turmoil, rising oil prices, appreciation of Indian rupee, and liquidity crunch. The bank's net profit from overseas business remained constant mainly on account of sharp decrease in the value of the Indian currency and additional provision requirements on investments. Nevertheless, the overseas business contributes 21.2% of the bank's gross profits during FY09. Further, it contributed 34.66% to the bank's income from commission. The bank has used its banking technology skillfully in overseas operations thereby keeping its cost to income ratio at 20.75%.

Table IV: Bank of Baroda Vs Peer Group

Key Ratios	BOB	Peers
Capital Adequacy		
CRAR (Basel II)	14.05%	13.51%
Tier I (Basel II)	8.49%	8.36%
Asset Quality (As % of Advances)		
Gross NPA	1.27%	1.93%
Net NPA	0.31%	0.66%
Loan Loss Coverage	75.52%	74.04%
Earnings		
NIM	2.91%	2.92%
Non-Interest Income (INR Billion)	27.57	21.66
ROA	1.15%	1.13%
ROE	19.56%	23.09%
Cost to Income Ratio	45.38%	44.06%
Liquidity		
CASA	29.59%	32.70%
Credit Deposit Ratio	74.84%	72.44%
Operating Ratios		
Cost of Deposits	5.71%	6.48%
Yield on Advances	9.50%	9.13%

BWR has made a study of the performance of Bank of Baroda vis-à-vis its peers in certain key parameters as given in the table above. BWR rating methodology has defined peer banks as those with closely similar size/operation as Bank of Baroda.

The bank's capital adequacy ratio under Basel II stood at 14.05% as on 31st March 2009, which is 54 bps higher than its peers' average of 13.51%. Similarly, the bank's Tier I capital stood at 8.19% under Basel II, which is 13 bps higher than its peers' average of 8.36%. The bank's Tier II capital is expected to improve with the proposed upper Tier II bonds issue of INR 10.00 billion.

During FY09, the bank had witnessed a reduction in non-performing assets. The bank's gross and net NPAs have reduced to 1.27% and 0.31% respectively during the year. Further, the bank's gross NPAs were significantly lower (66 bps) than its peers' average of 1.93%. Similarly, the net NPAs were 35 bps lower than its peers' average of 0.66%. The bank has consistently maintained better NPA provisions over the years. During FY 09,

the bank's loan loss provision is comfortable at 75.52% (75.09% in FY08), which is 148 bps higher than its peers. With strong cash recoveries (INR 5.53 billion) from written off accounts and PWO accounts (INR 2.63 billion), the bank was able to maintain a sound asset quality during FY 09.

It is observed that the bank's global net interest margin (NIM) has increased marginally from 2.90% in FY08 to 2.91% in FY09, marginally lower than its peers' average of 2.92%. Nevertheless, the bank's domestic NIM has stood at 3.21% during FY09.

The bank has posted strong non-interest income during the year. As a result, the bank's non-interest income grew by 34.45% to INR 27.57 billion, which is INR 5.91 billion higher than its peers. Similarly, the bank's return on assets (1.15%) were 3 bps higher than its peers' average of 1.13%, however, the return on equity is 353 bps lower than its peers' average. Further, the cost to income ratio stood at 45.38% during the year, which is 132 bps higher than its peers' average, however, the overseas operations cost to income ratio was at 20.75% during FY09.

The bank has the lowest cost of deposits among its peers as on 31st March 2009, which is stood at 5.71%. In spite of lowest cost of deposits, the bank's yield on advances was 37 bps higher than its peers' average of 9.13%.

Shortcomings:

In the analysis of the Bank of Baroda's performance for FY 09, a few shortcomings as under have been noticed.

- a) The bank has restructured nearly 40,423 accounts, amounting to total outstanding INR 26.59 billion during FY09. The bank's restructured loan amount is one of the lowest amounts reported in the industry so far, which is only 1.85% of the total advances. Brickwork expects that the bank's restructured loans likely to affect the asset quality in near future.
- b) The bank's CBS coverage is a mere 67.94% . Improved coverage can reduce cost income ratio in future years.

Mitigants:

The bank has taken enough steps to overcome the aforesaid deficiency to bring about required improvements in asset quality, operating expenses and low cost deposits. The bank continues to focus on 'growth with quality' by focusing on mobilizing more low cost deposits, lean operating structure by leveraging CBS platform, reducing dependence on bulk deposits, and protecting the asset quality with continuous monitoring on loan originations and disbursement. Further, the bank is planning to open 168 new branches current financial year primarily in rural and semi-urban regions. This would help the bank to garner more lost cost deposits. Overall the bank is taking necessary steps for overcoming the deficiencies.

Bank Profile:

Incorporated in 1908, Bank of Baroda is one of the oldest public sector banks in India. The bank has always been in the forefront to improve its productivity and efficiency. Over the years the bank has been transforming itself from core banking activities to universal banking solutions.

The bank has positioned itself very well in the domestic market. As a result, the bank was able to mobilize relatively huge deposits. The bank continues to expand its technology driven customer-centric products and services to serve effectively its ever growing customer base. The bank's product and services consist of international trade finance, supplier credit, treasury products, foreign currency loans, structured financial solutions, payments and receipts, remittance, merchant banking advisory services, etc.

During FY 09, the bank opened 73 new branches by merging 9 branches. The bank however spread its branches across four regions namely metro, urban, semi-urban and rural in the domestic market to serve effectively all sections of the population. The key positive is 59.80% of the bank's domestic branches located in the rural and semi-urban areas that would help the bank to increase its low cost deposits base. Overall, the bank's distribution channel consists of 2926 branches and 1179 ATMs as of 31st March 2009.

The Government of India (GoI) is a major stakeholder of Bank of Baroda with ownership stake of 53.8%. In order to become a universal bank, 1922 domestic and 66 overseas branches of the bank have moved to the core banking solutions (CBS) platform. During

the year, the bank has launched many technology driven services such as biometric ATMs, online payment of direct taxes and online railway ticket booking facility.

Rating Outlook:

Brickwork Ratings (BWR) issue rating is based on CAMEL-TP framework, which is used to assess the bank's financial fundamentals and risk exposures. The rating assigned to Bank of Baroda is specific to the proposed Upper Tier II bonds issue of INR 1000 crore or INR 10.00 billion. The rating factored majority stake held by Government of India, well diversified loan portfolio, comfortable capital adequacy and domestic low cost deposits, profitable overseas operations, strong interest and non-interest income, and healthy earning assets.

Brickwork expects that current liquidity situation; huge borrowing programs of the Government of India and continuing financial crises in the international markets are likely to affect the bank's operations. However, the bank's improved earning assets, robust growth in advances and deposits, decline in NPAs, comfortable capital adequacy, efficient risk management system, and higher domestic low cost deposits would enable the bank to sustain its current growth momentum in domestic and overseas operations. As such Brickwork has assigned **Stable** outlook for the bank's issue.

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