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## Rating Rationale for Bank of India's Innovative Perpetual Debt Instrument Issue of INR 325 crore or INR 3.25 billion

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**Issue Rating: BWR AAA**

**Outlook: Stable**

Brickwork Ratings has assigned BWR AAA (Pronounced BWR Triple A) for Bank of India's proposed Innovative Perpetual Debt Instrument (IPDI) Issue of INR 325 crore or INR 3.25 billion.

### Outstanding Ratings

Rating	Issue Date
Issuer Rating	December 2008
Issue Rating of IPDI issue of Rs 400 crore	January 2009

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. Brickwork has relied upon the audited financial statements, information and clarifications provided by the issuer. The rating factored, inter alia, the Bank's performance, comfortable capital adequacy, asset quality, and the Government of India's ownership stake.

Despite economic downturns in the domestic market and financial crises in the international markets, Indian public sector banks managed to post decent growth during FY 09. Bank of India's gross deposits showed a growth rate of 25.46% in FY09 as compared to the previous year, and by 22.47% in Q1 FY 10. Similarly, the bank's gross advances grew by 26.08% and 20.28% in FY 09 and Q1 FY 10 respectively. During the year, the bank was able to increase its deposits market share from 3.89% to 4.13% and healthy growth in domestic advances led to increase its market share from 3.87% to 4.16% in FY 09. Further, the bank has strengthened its deposit profile by mobilizing strong (79.10%) retail deposits in FY 09.

Brickwork calculates Leverage that assesses bank's capital with reference to both on and off balance sheet exposures. Bank of India has shown a lower leverage of 19.85 in FY 09 as compared to the previous year figure of 22.41. The bank's lower leverage is positive compared to its peer group's 21.91 as on 31st March 2009.

**Table 1: Bank of India Performance Indicators**

<b>Criteria (Rs Crore)</b>	<b>FY 09</b>	<b>FY 08</b>	<b>FY 07</b>
<b>Total Assets</b>	225,501	178,829	141,816
<b>Deposits</b>	189,708	150,011	119,881
<b>Advances</b>	142,909	113,476	85,115
<b>Investments</b>	52,607	41,802	35,492
<b>Income</b>			
<b>Interest Income</b>	16,347	12,355	8,936
<b>Non-Interest Income</b>	3,051	2,116	1,562
<b>Net Interest Income</b>	5,498	4,229	3,440
<b>Profit</b>			
<b>Operating Profit</b>	5,456	3,701	2,395
<b>Net Profit</b>	3,007	2,009	1,123
<b>Non-Performing Assets</b>			
<b>Gross NPAs</b>	1.71%	1.68%	2.42%
<b>Net NPAs</b>	0.44%	0.52%	0.95%
<b>CRAR</b>	13.01%	12.04%	11.75%
<b>Tier I</b>	8.91%	7.70%	6.53%
<b>ROA</b>	1.49%	1.25%	0.88%
<b>ROE</b>	30.42%	28.44%	22.28%
<b>Provision Coverage Ratio</b>	74.58%	81.25%	69.91%

Over the years, the bank has been showing steady growth in asset base aided by a robust growth in deposits, and strong growth in advances. As a result, the bank has achieved 26.09% growth in total assets during FY09. As regards investment activities, the ratio of G-sec to net domestic investment is at 88.67% in FY09. In line with public sector banks, Bank of India has maintained high proportion of its domestic investments in the HTM category.

BOI's gross NPA marginally increased to 1.71% in FY 09 as compared to the previous year figure of 1.68%. Due to higher profits, the bank was able to provide healthy provisions during FY 09, which in turn helped to reduce its net NPAs to 0.44% as against 0.52% in FY 08. However, the bank's provision coverage ratio has declined from 81.25%

in FY08 to 74.58% in FY09. Further, the bank's slippages have increased in both absolute (from Rs 1,365 crore to Rs 2099 crore) and percentage terms (from 1.23% to 1.49%) during the year. NPAs in below Rs. 25 lakh category have accounted for major increase in FY09. During Q1 FY 10, the bank's gross and net NPAs have increased to 1.89% and 0.89% respectively.

With total income of Rs 19,399 crore during FY 09 (as against Rs 14,472 crore in FY08), reflecting the considerable improvement in core banking operations (35.19%), strong growth in treasury income (103.72%) and significant fee based activities(39.44%). The bank's net interest income has registered an impressive growth rate of 30.03% to reach Rs 5998 crore during FY09. Similarly, the bank's other income has grown by 44.16%.

The bank's profitability stands at the top end of the range of public sector banks in India. However, the bank's strategic domestic positioning and the supportive foreign market conditions that prevailed in recent years have equally contributed to the bank's profitability. The bank's profitability has increased during FY09, which is largely driven by strong growth in the core banking operations. The bank's net profit also increased to Rs 3,007 crore in FY 09 from Rs 2,009 crore in FY 08, with an impressive growth of 49.68% over the previous year.

**Table 2: Financial Performance**

Parameter (Rs Crore)	2008-09	2007-08
<b>Interest Income</b>	16,347	12,355
<b>Interest Expenses</b>	10,848	8,125
<b>Net Interest Income</b>	5,498	4,229
<b>Non-interest Income</b>	3,051	2,116
<b>Operating Income (PBDITA)</b>	15,125	10,863
<b>Employee Expenses</b>	1,953	1,665
<b>Other Operating Expenses</b>	1,140	979
<b>Operating Profits (PBIT)</b>	15,053	10,789
<b>Provisions &amp; Contingencies</b>	2,449	1,691
<b>Profit After Tax</b>	3,007	2,009

As of 31<sup>st</sup> March 2009, the bank's Tier 1 capital ratio under Basel II stood at a fairly high 8.91% as compared to 7.70% a year earlier. During the financial year, the bank increased its Tier I capital by Rs 400 crore through issue of Innovative Perpetual Debt Instrument (IPDI).

As on 31<sup>st</sup> March 2009, the bank's capitalization levels are comfortable, reflected by bank's capital ratio of 13.01% under Basel II as compared to previous year figure of 12.04%. Further, the net worth of the bank stood at Rs 11,143 crore in FY 09 with a growth rate of 29.16% over the previous year. During the year, the bank's Return on Assets (ROA) had improved significantly to 1.49% as compared to 1.25% in FY08, which, however, has declined to 1.03% in Q1 FY 10. The bank's Return on Equity (ROE) has shown a similar trend, which has increased to 30.42% as on 31<sup>st</sup> March 2009 as against 28.44%.

The bank has been growing its overseas business presence judiciously. With opening up of a branch at Glasgow, United Kingdom and representative office in Dubai during the year, the bank's offices abroad increased to 28 as on 31<sup>st</sup> March 2009. The bank's international operation has witnessed good growth in spite of global economic crisis. However, the bank's international operation net profit had come down by 4.84% due to higher provisioning.

**Table 3: Bank of India Vs Peer Group**

<b>Key Ratios FY 09</b>	<b>BOI</b>	<b>Peers</b>
<b>Capital Adequacy</b>		
CRAR (Basel II)	13.01%	13.60%
Tier I (Basel II)	8.91%	8.38%
<b>Asset Quality (As % of Advances)</b>		
Gross NPAs	1.71%	1.82%
Net NPAs	0.44%	0.60%
Loan Loss Coverage	74.58%	74.28%
<b>Earnings</b>		
NIM	2.97%	2.92%
Non-Interest Income (Rs Crore)	3,051	2,005
ROA	1.49%	1.13%
ROE	30.42%	22.50%
Cost to Income Ratio	36.51%	44.03%
<b>Liquidity</b>		
CASA	31.00%	33.05%
Credit Deposit Ratio	75.14%	72.84%

<b>Operating Ratios</b>		
Cost of Deposits	5.76%	6.35%
Return on Funds	8.09%	9.19%

BWR has made a study of the performance of Bank of India 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 the Bank of India.

The bank's capital adequacy has been improving over the years. During FY 09, the bank's capital adequacy ratio under Basel II stood at 13.01%, which is 59 bps lower than its peers' average of 13.60%. However, the bank's Tier I capital (8.91%) under Basel II was significantly (53 bps) higher than its peers' average of 8.38%. The bank's proposed IPDI issue of Rs 325 crore would improve the capital adequacy further.

The bank's gross NPAs have grown marginally to 1.71% in FY 09 from 1.68% in FY 08, which is 11 bps lower than its peer banks as on 31<sup>st</sup> March 2009. However, the bank's net NPAs have decreased to 0.44% in FY 09 from 0.52% in FY 08, which is 16 bps lower than its peers' average. During the year, the bank's provision coverage was 2.30% higher than its peers' average.

The bank's net interest margin and ROA was higher than its peers' average. Similarly, the bank has posted an impressive other income during the year, which is higher than its peers' average. With strong growth in core income, an impressive other income and lean operating structure, the bank's cost to income ratio had decreased significantly to 36.51%, which is far lower than its peers' average of 44.03%.

The bank's low cost deposits had come down to 31% in FY 09 from 36% in FY 08, which has increased to 32% in Q1 FY 10. However, the bank's low cost deposits were 2.05% lower than its peers' average.

### **Shortcomings:**

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

- a) The share of CASA deposits has slipped from 36% as on 31<sup>st</sup> March 2008 to about 31% by 31<sup>st</sup> March 2009.

- b) The bank has restructured nearly 35,577 accounts, which is 3.36% of its loan outstanding during FY09. The bank is yet to restructure 1740 accounts amounting to Rs. 1,966 crore. These could affect the asset quality in near term. As on 31<sup>st</sup> March 2009, the bank's total distressed assets stood at 4.71% of the advances.

### Mitigants:

Brickwork expects that the bank will adopt a prudent strategy to overcome above mentioned limitations. With 62% branches in rural areas, the bank is in a position to generate the more low cost deposits. The asset quality is cause for concern as the bank has grown its credit portfolio aggressively. In this regard, the bank has decided that NPA management will be its priority in the current financial year.

### Industry Snapshot:

Over the years, the Indian banking sector has benefited from a stable macro economic environment. The financial year 2009 witnessed a steady deterioration in the global financial conditions, which tightened the liquidity position and affected the credit off-take. The Indian banking sector has skillfully tided over the crisis with un-paralleled support and measures to stimulate the economy from the government and RBI. While economic activity seems to be picking up, nevertheless caution and continuous monitoring need to be kept by the Banks till the crisis completely blows over.

As scheduled, the banks have successfully implemented the Basel II norms during financial year 2009 in spite of financial crisis in the domestic market. The public sector banks especially have shown a positive growth on account of proactive measures taken by the government during the year.

### Bank Profile:

The bank's largest shareholder, the Government of India (GoI), holds 64.47% stake.

Shareholders	Stake
Government of India	64.47%
Financial Institutions	11.00%
Foreign	16.27%
Retail	8.26%

The bank's strategy is consistent over the years, mainly focusing on corporate credit, SME credit, agriculture loans, EXIM services, derivative products, syndicate loans, project finance, and sale of third party products, NRI services and retail banking. In addition, it has a joint venture with Bombay stock exchange for managing the BSE clearing house. The bank had 3091 branches as on 31<sup>st</sup> March 2009.

### Rating Outlook:

The issue rating given by Brickwork Ratings (BWR) 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 India is specific to the proposed Innovative Perpetual Debt Instrument (IPDI) issue of Rs 3.25 crore or Rs 3.25 billion. The rating has factored Bank's profits, strong fee based income, adequate capital adequacy, assets quality, lean operating cost structure and the Government of India's equity stake. The amount of assets restructured and increasing trend of NPAs is a cause of concern and could have an adverse impact on the bank's asset quality in the near term. The Bank has strong fundamentals and Brickwork expects the bank to take appropriate measures quickly to improve the asset quality, improve the loan coverage ratio and continue to show strong and sustainable growth.

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