Canara Bank

September 03, 2020

Ratings

Instrument	Amount (Rs. crore)	Rating[1]	Rating Action
Basel III Compliant Tier-II bonds	3,000.0	**CARE AAA; Negative (Triple A); Outlook: Negative**	**Rating reaffirmed and removed from credit watch with developing implications**
Bonds-Tier II Bonds	4,400.0*	**CARE AAA; Negative (Triple A); Outlook: Negative**	**Assigned**
Basel III Compliant AT-I bonds	3,250.0*	**CARE AA; Negative (Double A); Outlook: Negative**	**Assigned**
Total	10,650.0 **(Rs. Ten thousand six hundred and fifty crore only)**		

Details of instruments/facilities in Annexure-1; *Transferred from erstwhile Syndicate Bank pursuant to its amalgamation with Canara Bank.

Tier-II Bonds under Basel III are characterized by a 'Point of Non-Viability' (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising Common Equity Tier-I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable. In CARE's opinion, the parameters considered to assess whether a bank will reach the PONV are similar to the parameters considered to assess rating of Tier-II instruments even under Basel II. CARE has rated the Tier-II bonds under Basel III after factoring in the additional feature of PONV.

CARE has rated the aforesaid Basel III Compliant Additional Tier-I Bonds after taking into consideration its key features as mentioned below:

- The bank has full discretion at all times to cancel coupon payments.
- The coupon is to be paid out of current year profits. However, if the current year's profits are not sufficient, i.e., payment of such coupon is likely to result in losses during the current year, the balance of coupon payment may be made out of revenue reserves and/or credit balance in profit and loss account provided the bank meets the minimum regulatory 2 CARE Ratings Limited Press Release requirements for Common Equity Tier I [CET I], Tier I and Total Capital Ratios and capital buffer frameworks as prescribed by the Reserve Bank of India [RBI].
- The instrument may be written-down upon CET I breaching the pre-specified trigger of 5.5% before March 31, 2019, and 6.125% on and after March 31, 2019, or written-off / converted into common equity shares on occurrence of the trigger event called point of non-viability (PONV). The PONV trigger shall be determined by RBI. Any delay in payment of interest/principal (as the case may be) due to invocation of any of the features mentioned above would constitute as an event of default as per CARE's definition of default and as such these instruments may exhibit a somewhat sharper migration of the rating compared with other subordinated debt instruments.

Detailed Rationale & Key Rating Drivers

The rating of Bonds issue of Canara Bank was earlier placed under credit watch with developing implications due to ongoing amalgamation process of Syndicate Bank with Canara Bank. The watch is resolved following completion of the amalgamation process w.e.f. April 1, 2020 and assessment of the merged entity's financial and business risk profile.

The merged entity has emerged as fourth largest Public Sector Bank (PSB) increasing its market presence and importance to Government of India (GOI). The shareholding of GOI in Canara Bank stood at 78.55% as on June 30, 2020. CARE takes note of significant losses reported by the merged entity during Q4FY20 due to higher provisions. Historically, provision coverage ratio (PCR) excl. written off accounts of these two Banks have been relatively lower than it's peer PSBs in its rated category. Though these higher provisions have significantly improved PCR, it has also led to deterioration in capital adequacy parameters. RBI had mandated Banks to maintain CET-I, Tier-I and Total CAR at 8%, 9.5% and 11.5% by March 31, 2020 (including capital conversion buffer) but subsequently deferred by two quarters to Sep 30, 2020. Merged entity's Tier-I and CET I are barely above the regulatory capital requirement as required on Sep 30, 2020. Against this backdrop, uncertainty over asset quality pressure due to Covid-19 on an already moderate solvency position of the Bank and low capital cushion to absorb any unexpected slippages and higher provisioning requirements which may arise due to restructuring, is reflected in the Negative outlook assigned to Bond issue of Canara Bank. CARE has rated AT1 bond issue two notch lower than Tier-II bond issue on account of relatively low distributable reserve cover to outstanding AT1 bonds.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Nevertheless, post amalgamation, the merged entity enjoys the benefits of larger balance sheet size and wider geographic reach leading to deeper penetration.
The rating of Canara Bank continues to derive strength from majority ownership by Govt. of India (GoI) from which it has been receiving timely capital infusion and experienced management and governance. The rating also continues to derive strength from its established retail franchise with strong network in southern states of India, comfortable liquidity profile and moderate resource profile with relatively low CASA share but high retail deposit. RBI's recent regulation regarding opening of current accounts by borrowers only with banks who have lent substantial loans is expected to improve current account share of large PSB banks including Canara Bank. Bank's asset quality has been modest with continuing slippages and resultant high credit cost impacting its earnings profile. Further, Canara Bank has relatively high share of loan book under moratorium (22.67% value share of loan book under moratorium) whose repayment behaviour post completion of moratorium on August 31, 2020 also remain to be seen.
While the Bank has reported profits in Q1FY21, going forward, the ability of the bank to limit incremental slippages and credit cost and maintain asset quality would be critical to the earnings profile of the bank and the same will be a key rating sensitivity.

Rating Sensitivities

Positive factors-Factors that could lead to positive rating action/upgrade
- Not Applicable

Negative factors- Factors that could lead to negative rating action/downgrade
- Significant slippages impacting earnings profile and deterioration in Net NPA to networth.
- Deterioration in capitalisation levels on a sustained basis and inability to maintain sufficient cushion over the regulatory capital.

Outlook: Negative

The negative outlook reflects likelihood of continuing asset quality pressure in a challenging macro environment and limited capital cushion available with bank to absorb further losses. Though the Bank has received Board approval to raise capital through QIP and AT1 bond issues, timely raising of funds is critical. The outlook may be revised to 'Stable' in case Bank is able to contain incremental slippages and is able to create sufficient capital cushion over and above regulatory requirement. Outlook revision on AT1 bonds will also further depend upon Bank's ability to improve distributable cover reserve over AT1 bonds outstanding.

Detailed description of the key rating drivers

Key Rating Strengths

Majority ownership by Government of India (GOI) and demonstrated support: Government of India (GoI) continues to have majority stake in the bank from which CB has received timely capital infusion and experienced management and governance and the same is expected to continue. As per directive from Ministry of Finance, GOI, Syndicate Bank (SB) has merged with Canara Bank (CB) effective from April 01, 2020. The amalgamated bank is the 4th largest PSB post amalgamation increasing the strategic importance of the bank. During past five FY's (FY16-FY20) GOI has infused Rs.21,449 crore on a combined basis in Canara Bank and Syndicate Bank. As part of its recapitalization plan, GOI had infused Rs.6,571 crore during September 2019. However post the pandemic, government is yet to announce any fresh capitalization plan for PSU banks. Government of India is the majority shareholder, holding 78.55% stake as on June 30, 2020.
Merger update: Bank has completed integration process in terms of policies and processes for services provided to customers and customers of both Canara Bank and e-Syndicate Bank can avail the services from any of the branches of the merged entity. Treasury operations and IT processes have been successfully integrated from April 01, 2020. However, branch rationalization process and certain staff transfer decision has not been decided in order to not disrupt the normal functioning of bank with restrictions in place due to COVID-19.

Established franchise and deposits base with a strong presence in the southern states: Post amalgamation, the merged entity enjoys the benefits of larger balance sheet size and wider geographic reach leading to deeper penetration. Total business of the bank stood at Rs.15.60 lakh crore as on June 30, 2020 with deposit base of Rs.9.09 lakh crore and advances of 6.50 lakh crore. Bank has an established presence with network of 10,403 branches and 13,451 ATMs as on June 30, 2020. With both banks being based out of South India, CB has a strong network with 4785 branches and deposit base especially in South India.

Moderate resource profile with relatively low CASA share but high retail deposit: Aided by widespread branch network, on merged basis, bank has witnessed steady growth in the bank's low-cost CASA deposits, which grew at a modest ~16% YoY to Rs. 2.94 lakh crore as on June 30, 2020 from Rs. 2.53 lakh crore as on June 30, 2019 while the bank's share of CASA in domestic deposits improved to 33.82% as on June 30, 2020 from 30.21% as on March 31, 2019. RBI announced new rules and regulations regarding opening of current account (CA), where companies are required to open CA or cash-credit/overdraft accounts only with banks who have lent substantial loans to them and the same is expected to improve CA share of large PSB banks including

Canara Bank. Share of bank retail term deposit, improved to 61.59% as on June 30, 2020 from 54.43% as on June 30, 2019. Bulk deposits formed 25.98% of the total deposits as on June 30, 2020.

Key Rating Weaknesses

Weak capitalization levels due to loss reported by bank during Q4FY20 but significant improvement in PCR: On combined basis, CB+SB reported net loss of Rs. 5538 crore for FY20 as against net loss of Rs. 1755 crore reported by CB on account of high provisioning of Rs.8,979 crore during Q4FY20 (CB+SB). High provisioning is partly attributable to harmonization of asset classification between the merging banks. Further, historically, PCR of these two Banks have been relatively lower than it's peer PSBs. Though these higher provisions have significantly improved PCR (including written off accounts) from 68.75% as on March 31, 2019 to 76.75% as on March 31, 2020, it has also led to deterioration in capital adequacy parameters. Bank's CAR, Tier-I CAR and CET-I stood at 12.77%, 9.29% and 8.15% as on June 30, 2020. RBI had mandated Banks to maintain CET-I, Tier-I and Total CAR at 8%, 9.5% and 11.5% by March 31, 2020 but subsequently deferred by two quarters to September 2020. CB+SB's Tier-I and CET I are just above the regulatory capital requirement. Without immediate capital infusion, bank's Tier I is likely to fall below the regulatory norms required for September 2020. Bank has received Board approval to raise capital through QIP and AT1 bond issues, however timely raising of funds is critical to create sufficient capital cushion over and above will be key rating monitorable.

Weak earnings profile and significant losses reported in Q4FY20: Canara Bank's profitability has been under pressure due to relatively high cost to income ratio and high provisions. Bank's deposits have witnessed increase of 5.55% while advances witnessed marginal de-growth of 1.53% which led to decline in Net Interest Income (NII) of 3.94% to Rs.20295 crore in FY20. However, aided by healthy increase of 22.54% in non-interest income, Bank reported growth in total income of 5.57%. NIM of the bank witnessed marginal decline to 2.01% in FY20 compared to 2.12% in FY19. Further, with increase of cost to income of the bank to 58.81% in FY20 as against 55.07% in FY19, merged bank reported lower pre provisioning operating profit (PPOP) of Rs.12,834 crore in FY20 (FY19:Rs.13,475 crore). Increase in operational expenses of the bank during FY20 was majorly on account of provisions made pursuant to proposed bipartite agreement on wage revision (due with effect from November 1, 2017). Bank's cost to income continues to remain high compared to its peers. Further Bank continued to have high provisioning (excluding tax) in FY20 of Rs.18,372 crore (FY19: Rs. 18,840 crore) on account of continued slippages. Owing to these factors, the bank's net loss increased to Rs.5840 crore in FY20 as against net loss of Rs.2,177 crore in FY19 (on merged basis). CB+SB on a combined basis has reported net losses during past three FY's.
Bank's profitability has witnessed improvement during Q1FY21 and reported PAT of Rs.406 crore. Bank's provision coverage ratio (including technical write offs) has significantly improved from 68.75% as on March 31, 2019 to 76.75% as on March 31, 2020 and further to 78.95% as on June 30, 2020. Albeit improvement PCR excluding technical write offs provision coverage ratio of Bank continues to remain low at 57.66% as on June 2020 (Mar'19: 44.32%) compared to its peers leading to higher provisioning requirement due to ageing of NPA. Bank's ability to report consistent profits is a key rating monitorable given the uncertainty regarding asset quality pressures.

Modest asset quality: Bank's asset quality continues to remain moderate albeit improvement during FY20 and Q1FY21. Bank's Gross NPA ratio improved to 9.39% (March 31, 2019: 9.66%) and Net NPA ratio improved to 4.34% (March 31, 2019: 5.62%). Bank continued to witness high slippage during FY20, the reduction in NPAs was on account of higher amount of recoveries and write-off during FY20. Aided by lower net slippages, higher amount of recoveries and write-off during Q1FY21 bank's asset quality has further improved with GNPA and NNPA at 8.84% and 3.95% respectively as on June 30, 2020. and the same has resulted in improvement of NNPA/ Net worth to 61.54% as on March 31, 2020 as against 85.20% as on March 31, 2019 albeit the same continues to be higher compared to its peers. Going forward, with challenging macro environment due to COVID-19 and with 22.67% value share of loan book under moratorium, the ability of the bank to limit incremental slippages or restructuring and maintain asset quality would be critical to the earnings profile of the bank and the same will be a key rating sensitivity.

Liquidity: Strong

According to the bank's structural liquidity statement (SLS) as on June 30, 2020, there are no negative cumulative mismatches in up to 1 year maturity bucket. Further, bank has maintained an excess SLR investment of Rs.81,820 crore as on March 31, 2020. These factors provide cushion to the bank's liquidity profile. CB's liquidity coverage ratio remained adequate at 126.54% for quarter ended June 30, 2020 against the minimum regulatory requirement of 80% (till September 30, 2020). (90% from October 01, 2020). Further, the bank has access to market liquidity support like Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) from RBI.

Analytical approach: Standalone along with expected support from GOI.

Applicable Criteria
[Financial Ratios – Financial Sector]
[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings]
[CARE's Policy on Default Recognition]
[Rating Methodology – Banks]
[Bank - Rating framework for Basel III instruments (Tier I & Tier II)]
[Rating Methodology: Consolidation and Factoring Linkages in Ratings]

About the Company
Canara Bank (CB) is a Bengaluru-based public sector bank which was established in 1906. As per directive from Ministry of Finance, GOI for amalgamation of Syndicate Bank (SB) into Canara Bank the merger has become effective from April 1, 2020. The amalgamated bank is the 4th largest PSB post amalgamation. Government of India is the majority shareholder holding 78.55% stake in the bank followed by LIC of India holding 6.34% as on June 30, 2020. As on June 30, 2020, the Bank (on combined basis) had 10,451 branches, of which 3,079 are in rural, 3,175 in semi urban, 2,073 in urban and 2,124 in metro areas. The bank also has 5 overseas branches located at Johannesburg, New York, London, Hong Kong and Dubai. Mr. Lingam Venkata Prabhakar is the MD and CEO, w.e.f February 01, 2020, who is assisted by a team of Executive Directors and General Managers heading various departments. As on June 30, 2020, the bank had advances of Rs.6,50,574 crore and deposits of Rs.9,09,570 crore.

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3.*

Brief Financials (Rs. crore)	FY19(A)	FY20(A)	FY20*	Q1FY21 (UA)*
Total operating income	53,385	56,748	81,710	20,686
PAT	347	-2,236	-5,840	406
Total Assets	6,84,983	7,13,741	10,28,429	10,25,130
Net NPA (%)	5.37	5.05	4.34	3.95
ROTA (%)	0.05	-0.32	-0.58	0.16

*A: Audited; *Combined Financials of CB+SB.*
Note: All Analytical ratios are as per CARE's calculations.
Total Assets exclude deferred tax assets and are net of revaluation reserve

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN No.	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Tier II Bonds	INE476A08076	March 11, 2020	7.18%	March 11, 2030	3000.00	CARE AAA; Negative
Bonds-Lower Tier II bonds#	INE667A09177	December 31, 2012	9.00%	December 31, 2022	1000.0	CARE AAA; Negative
Bonds-Tier-II bonds#	INE667A08021	December 02, 2014	8.75%	December 02, 2024	750.0	CARE AAA; Negative
Bonds-Tier-II bonds#	INE667A08013	March 23, 2015	8.95%	March 23, 2025	400.0	CARE AAA; Negative
Bonds-Tier-II bonds#	INE667A08039	September 28, 2015	8.58%	September 28, 2025	1000.0	CARE AAA; Negative
Bonds-Tier-II bonds#	INE667A08047	December 18, 2015	8.62%	December 18, 2025	750.0	CARE AAA; Negative
Bonds-Tier-II bonds#	INE667A08096	May 03, 2017	8.00%	May 03, 2027	500.0	CARE AAA; Negative
Bonds-Tier I bonds#	INE667A08070	July 15, 2016	11.25%	Perpetual	500.0	CARE AA; Negative
Bonds-Tier I bonds#	INE667 A08062	March 30, 2016	11.25%	Perpetual	370.0	CARE AA; Negative
Bonds-Tier I bonds#	INE667A08054	March 30, 2016	11.25%	Perpetual	930.0	CARE AA; Negative
Bonds-Tier I bonds#	INE667A08088	October 24, 2016	9.95%	Perpetual	1000.0	CARE AA; Negative
Bonds-Tier I bonds#	INE667A08104	July 25, 2017	9.80%	Perpetual	450.0	CARE AA; Negative

#Transferred from e-Syndicate Bank to Canara Bank

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Bonds-Tier II Bonds	LT	3000.00	CARE AAA; Negative	-	1)CARE AAA (Under Credit watch with Developing Implications) (03-Mar-20)	-	-
2	Bonds-Tier II Bonds	LT	4400.00	CARE AAA; Negative	-	-	-	-
3	Bonds-Tier I Bonds	LT	3250.00	CARE AA; Negative	-	-	-	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities

Basel III Tier-II bonds	Detailed explanation
Non-Financial covenants	
i. Conditions for exercise of call option	On or after the 5th anniversary date from the date of allotment or any anniversary issuer may at its sole discretion, having notified the trustee not less than 21 calendar days prior to date of exercise of such issuer call subject to prior approval of RBI subject to tax call/regulatory call or issuer demonstrates that its capital position is well above the minimum capital requirements after the issuer call is exercised.

Annexure 4: Complexity level of various instruments rated for this company

Sr No	Name of instrument	Complexity level
1	Tier II Bonds (Basel III)	Complex
2	Lower Tier II Bonds	Complex
3	Tier I Bonds (Basel III)	Highly Complex

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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