February 21, 2023

BoB Financial Solutions Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated debt programme	50.00	50.00	[ICRA]AAA (Stable); reaffirmed
Total	**50.00**	**50.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating takes into consideration the strong parentage of BoB Financial Solutions Limited (BFSL), which is a wholly-owned subsidiary (WOS) of Bank of Baroda (BOB; rated [ICRA]AAA (Stable) for Tier II bonds). BOB is India's second largest public sector bank (PSB) and the fourth largest bank in the Indian financial system in terms of total business (advances and deposits). As the credit card business is one of the key product offerings to its customers, BOB has stated that BFSL remains strategically important for it. This is also reflected in the track record of providing branding, management and funding support to BFSL and its stated intent of continuing to do so in future, as and when required. Additionally, BOB has continued to support BFSL's growth with capital infusions, including Rs. 300 crore in 9M FY2023 (Rs. 100 crore in FY2022). In addition to the credit card business, BFSL manages BOB's merchant acquiring business.

Driven by BOB's increased focus on expanding the credit card business, BFSL has seen a rapid growth in its credit card base over the last two years with the same expected to continue over the next few years. However, the overall asset quality levels have remained relatively weak given the profile of the customers with significant exposure to the self-employed segment. Efforts to scale up as well as to gradually increase the contribution of the salaried segment could support an improvement in the asset quality levels over time. The operating profitability in the card segment has also improved, supported by the higher card and receivables base along with cost containment measures.

Despite the sharp growth in credit card receivables and weak internal accruals, BFSL's gearing level[1] has remained steady at 5-6 times over the last few years on the back of capital infusions by the parent. As it continues to grow and the borrowing levels go up, the leverage is likely to increase from the current level but should remain below 6 times. However, till the profitability levels improve meaningfully, the dependency on capital support from the parent is likely to continue to support the growth over the near to medium term.

The Stable outlook reflects BOB's ownership and its willingness to extend managerial and funding support to BFSL, as and when needed, given its importance to the bank. Any dilution in the above stance or a downgrade in BOB's own rating will be a negative for BFSL's rating.

Key rating drivers and their description

Credit strengths

Strong parentage – BFSL is wholly owned by BOB and has stated that the credit card business is one of the key product offerings for its customers. Hence, BFSL is a strategically important entity for BOB. This is also reflected in the bank's track record of providing branding, management and funding support to the company. BOB is represented by five members on BFSL's board apart from two independent directors and its underwriting policies are approved by the board. BOB has renewed its focus on

[1] Leverage = Total debt/net owned funds

the card segment and intends to grow it profitably by tapping its huge customer base. It has inducted professional management team to grow the business.

Given the weak internal accruals, BFSL may need to raise equity capital in the near future. BOB has demonstrated its support through regular capital infusions of late, including Rs. 300 crore in 9M FY2023, which followed the Rs. 100-crore capital infusion in FY2022. While BOB is likely to support BFSL for its equity capital requirements, BOB/BFSL may explore the induction of a strategic investor, which will lead to a dilution in BOB's stake (currently 100%) in BFSL. However, BOB has stated that it will continue to maintain a majority equity stake in the company. In addition to the credit card business, BFSL undertakes the merchant acquiring business for BOB, which is managed on a cost-plus basis and requires minimal capital for operations in relation to its overall asset base.

Adequate capitalisation and liquidity position – BFSL's credit card receivables base grew sharply over the last few years and was largely funded through bank borrowings and commercial paper (CP). As a result, the total borrowings increased to Rs. 1,756 crore as on September 30, 2022 (Rs. 1,111 crore as on March 31, 2022). The capital adequacy ratio (CRAR) stood at 17.83% as on December 31, 2022 (21.79% as on September 30, 2022 with the Tier I at 18.48%), supported by the capital infusion of Rs. 300 crore in June 2022. BOB has indicated that it will provide capital support to BFSL as and when required.

The company maintains sufficient undrawn bank limits for CP maturities and for funding the expected growth in card receivables. Given the weak internal accruals, BFSL is expected to require capital to maintain Tier I capital of ~15% to fund growth despite the expected improvement in the profitability in FY2024.

Credit challenges

Market share remains marginal – The company's core business is the credit card segment. Credit card receivables account for more than 90% of BFSL's assets while the acquisition business is carried out on behalf of BOB on a cost-plus basis with limited fixed or working capital requirements. Despite being in business for over two decades, BFSL's market position in credit cards remains marginal at ~2% in terms of cards in force or credit card receivables as on September 30, 2022.

As the credit card segment remains relatively risky and losses upon default are high in this segment, the company could face significant volatility in earnings as well as leverage as seen during the last two years, further aggravated by the impact of the Covid-19 pandemic. Total gross slippages in H1 FY2023 stood at Rs. 83.2 crore (annualised slippage rate of 4% of standard receivables as on September 30, 2022) against Rs. 147.4 crore in FY2022 (12% of standard receivables as on March 31, 2022). Given the lower slippages, recoveries and write-offs, the gross non-performing advances (NPAs) moderated to 4.75% as on September 30, 2022 from 7.56% as on March 31, 2022.

Elevated credit costs keep internal accruals weak – As the card base grew by ~53%, credit card receivables increased by ~134% during FY2021-9M FY2023. This supported interest income and fee income and drove an improvement in the absolute operating profitability. The company's operating profit increased to Rs. 108 crore in 9M FY2023 (Rs. 80 crore in 9M FY2022; Rs. 110 crore in FY2022). However, it reported losses in FY2022 and 9M FY2023 due to elevated credit costs. Credit costs were up due to the high provision cover on NPAs as well as the meaningful scaling-up of the book, resulting in a sharp increase in standard asset/gross stage-1 provisioning. As a result, credit provisions stood at Rs. 127 crore in 9M FY2023 (Rs. 84 crore in 9M FY2022; Rs. 103 crore in FY2022), resulting in a loss before tax of Rs. 19 crore (loss before tax of Rs. 4 crore in 9M FY2022 and Rs. 6 crore in FY2022). The overall profitability levels are likely to remain sub-optimal in the near term, although profitability is likely to improve over the long term with gradual stability in the asset quality levels and benefits of a larger scale of operations. However, any material weakening in the macroeconomic environment, leading to higher slippages and elevated credit costs, will remain a monitorable.

Liquidity position: Adequate

Around 46% of BFSL's card receivables base consists of the transactor portfolio. Hence, a sizeable portion of the receivables mature over 1-2 months, resulting in positive asset-liability gaps across all maturity buckets as on September 30, 2022. As on January 31, 2023, the company had a cash balance of ~Rs. 70 crore and undrawn lines of ~Rs. 931 crore against which it had

CP repayments of Rs. 390 crore. BFSL's bank borrowings include overdraft and working capital demand loans and there are no term loans in the overall borrowings.

Rating sensitivities

Positive factors – Not applicable

Negative factors – ICRA could downgrade the rating in case there is a dilution in BFSL's importance to BOB or if the funding is inadequate to maintain the leverage at the stated level. Further, any change in the outlook or a downgrade in the credit rating of BOB will lead to a similar action on BFSL's rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for NBFCs Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group support	**Parent company: Bank of Baroda (BOB)** BFSL's rating factors in the parentage in the form of BOB and its stated intent to provide requisite management and funding support to BFSL as and when required BOB and BFSL share a common name, which, in ICRA's opinion, would persuade BOB to provide financial support to BFSL to protect its reputation from the consequences of a group entity's distress
Consolidation/Standalone	Standalone

About the company

BoB Financial Solutions Limited (BFSL), incorporated in 1994 and a wholly-owned subsidiary of Bank of Baroda (BOB), is a non-deposit taking non-banking financial company registered with the Reserve Bank of India. BFSL had a credit card base of ~15 lakh as of September 30, 2022. Its corporate as well as registered office is in Mumbai. The company operates through 40 area offices spread across the country.

In 9M FY2023, BFSL reported a net loss of Rs. 14.18 crore on operating income of Rs. 518.54 crore compared with a net loss of Rs. 8.78 crore on operating income of Rs. 325.97 crore in 9M FY2022.

Bank of Baroda

Bank of Baroda was incorporated in 1908 and nationalised in 1969, along with 13 other major commercial banks of India, by the Government of India (GoI). BOB is headquartered in Vadodara while its corporate office is in Mumbai.

On September 17, 2018, the GoI announced the merger of Vijaya Bank and Dena Bank with BOB. The merger came into effect on April 01, 2019. As of March 31, 2022, BoB had 8,168 branches and 10,033 ATMs across India, of which ~60% are rural/semi-urban branches. It has an international presence spanning 94 overseas offices across 17 countries. Post-merger, BoB became the fourth largest PSB in the Indian banking sector in terms of total business (advances and deposits cumulatively as on June 30, 2022). The GoI held a 63.97% stake in the bank as on September 30, 2022.

BOB reported a net profit of Rs. 9,334 crore in 9M FY2023 on a total asset book of Rs. 14.39 lakh crore[2]. Its GNPA% and NNPA% stood at 4.53% and 0.99%, respectively, as on December 31, 2022. The regulatory capital adequacy ratio stood at 14.93% as on December 31, 2022 (CET I: 10.83% and Tier I of 12.62%).

[2] *Excluding revaluation reserves*

Key financial indicators

	FY2021	FY2022	9M FY2022*	9M FY2023*
	IND AS	IND AS	IND AS	IND AS
Net interest income	82	141	103	167
Profit after tax	(10)	(10)	(9)	(14)
Net advances	743	1,245	1,013	2,667#
Total assets	947	1,519	1,274	3,021
RoA	-1.27%	-0.85%	1.37%	NA
RoE	-4.90%	-4.42%	-4.15%	-4.43%
Gross NPA	8.08%	7.55%	12.37%	4.90%
Net NPA	0.00%	1.18%	1.81%	1.00%
Solvency Ratio (Net NPA / NOF)	0.00%	9.39%	13.41%	6.79%
Tier I	12.80%	13.03%	14.78%	NA
CRAR	19.61%	17.86%	20.12%	17.83%
Leverage – Debt / NOF (times)	5.71	6.10	5.27	NA

Source: BFSL, ICRA Research; ^ Net of provisions; Amount in Rs. Crore; Gross Advances Rs.2,917 Crore
** Provisional numbers; All ratios as per ICRA's calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2023	FY2022	FY2021	FY2020
					Feb 21, 2023	Feb 22, 2022	Feb 22, 2021	-
1	**Subordinated debt programme**	Long term	50	50	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Subordinated debt programme	Highly Complex

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instruments credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE027208011	**Subordinated debt**	Mar-09-2021	7.65%	Mar-07-2031	50.00	[ICRA]AAA (Stable)

Source: BFSL

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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