Indian Bank

April 29, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Lower Tier II Bonds	500.00	500.00	[ICRA]AA+ (Positive); Reaffirmed
Total	**500.00**	**500.00**	

** Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in Indian Bank's (IB) majority sovereign ownership with the Government of India (GoI) holding 81.49% of the bank's equity shares as on March 31, 2019. The rating also factors in the bank's healthy and granular loan book growth and growing resource profile (CASA deposits have grown at a steady rate) aided by network expansion. The rating further factors in the bank's comfortable capitalisation profile with a healthy cushion over the regulatory capital ratios (IB's CET I[1] stood at 10.92% as on December 31, 2018 against the minimum regulatory requirement of 7.375%). Despite the increasing capital requirements from March 31, 2020, ICRA expects IB's capital profile to remain comfortable with an expected improvement in the asset quality and earnings profile in FY2020. As per ICRAs' estimates, the bank can sustain strong credit growth and maintain sufficient capital cushions, without any capital raise, even if it decides to provide for the stressed assets and significantly increase its provision cover ratio (PCR)[2].

Notwithstanding its strong capital profile, the bank's net profitability remained weak in 9M FY2019 with return on assets (RoA) of 0.27% against 0.65% in 9M FY2018. The deterioration was because of the weakening in the asset quality over the last few quarters and the resultant increase in credit costs. The accelerated recognition of stressed assets as non-performing in Q4 FY2018 (due to the RBI's circular on the revised framework for the recognition of stressed assets, issued in February 2018), coupled with the slippage of some large ticket corporate exposures in H2 FY2019, resulted in increased stressed assets for the bank. As a result, gross NPA (GNPA) and net NPA (NNPA) increased to 7.46% and 4.42%, respectively, as on December 31, 2018, from 7.37% and 3.81%, respectively, as on March 31, 2018. However, barring some vulnerable accounts, ICRA expects the slippages to ease and the asset quality to improve in FY2020. With the bank's operating profitability remaining satisfactory and its standard assets expected to grow, ICRA expects IB's profitability to improve going forward. However, the extent of improvement will be driven by the provision cover maintained by the bank on its stressed assets.

Outlook: Positive

The Positive outlook is driven by ICRA's expectations of an improvement in the asset quality, earnings profile and solvency levels, going forward. IB remains well-capitalised among public sector banks (PSBs), enabling it to pursue growth while maintaining a comfortable cushion over the regulatory capital ratios. The rating will be upgraded if the bank's performance is in line with the expected levels stated earlier. Conversely, the outlook will be revised to Stable if higher-than-estimated slippages weaken the profitability profile, solvency and capital cushions.

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[1] *CET I stands for common equity tier I (capital ratio)*
[2] *PCR would be calculated without taking into consideration the technical write-offs (TWOs)*

Key rating drivers

Credit strengths

Sovereign ownership – IB has a majority sovereign ownership with the GoI's shareholding at 81.49% as on March 31, 2019. While the bank has not received equity capital from the Government in the last two financial years (FY2017-19) because of its comfortable capital profile, ICRA expects support from the GoI to be forthcoming if required. IB is the eighth largest PSB, in terms of asset base, with a share of ~2% in net advances of the banking system. However, to comply with SEBI's requirement of minimum public shareholding for companies listed on stock exchanges, IB may need to raise capital from non-Government sources to dilute the GoI's shareholding to ~75% (or less).

Improved granularity of loan book with higher growth in RAM segments – IB's gross loan book grew 16% YoY to Rs. 1,76,864 crore as on December 31, 2018 from Rs. 1,53,210 crore as on December 31, 2017. The growth was driven by the healthy credit offtake in the retail, agriculture and MSME (RAM) segment, which grew by 21% YoY and accounted for ~59% of the domestic book as on December 31, 2018, up from 56% as on December 31, 2017. Within RAM, the agriculture segment (21% of gross advances as on December 31, 2018), grew the fastest at 26% YoY, aided by growth in the secured agriculture portfolio, while MSME (18%) grew at 19% YoY. Retail loans (17%) grew at 17% YoY, mainly on account of healthy growth in home loans, which accounted for 64% of retail segment loans. With comfortable capital ratios and a growing retail franchise, ICRA expects IB to maintain loan book growth of 8-10% in the near-to-medium term. The loan book remains granular with the top 20 accounts contributing ~12% to the gross advances as on December 31, 2018 against ~13% as on September 30, 2017.

Capitalisation profile remains comfortable; IB expected to remain well capitalised with no capital requirement in FY2020 – IB's reported CET I, Tier I and CRAR stood at 10.92%, 11.24% and 12.67%, respectively, as on December 31, 2018, well above the regulatory capital requirements[3]. Despite the increased credit costs due to asset quality pressure and growth in advances, the bank's capital cushions have improved over the last one year, supported by the rationalised growth in risk-weighted assets (RWAs). The management has guided towards maintaining a capital cushion of 1-1.5% over the regulatory ratios in FY2020.

While the GoI infused Rs. 1.06 lakh crore in PSBs in FY2019, as a part of its bank recapitalisation programme, IB did not receive any capital considering its comfortable capital profile and better standing among PSBs. The bank has board approval for raising equity capital of Rs. 7,000 crore in one or more tranches through various means like qualified institutional placement (QIP), etc. Further, the management has guided towards a capital raise of ~Rs. 800 crore via the employee share purchase scheme (ESPS) in FY2020. It raised Rs. 1,000 crore in FY2019 via the issuance of Tier II bonds.

Assuming a CAGR of 8-10% in RWAs and a provision cover of 68-70%, thereby translating into RoA of 0.3-0.4% in FY2020, ICRA expects the bank to remain sufficiently capitalised till March 31, 2020 with a capital cushion of over 2% of CET I levels. Equity capital raising, if any, will only improve the capital cushions from the above expectations.

IB had Rs. 500 crore (0.32% of RWA) of AT-I bonds outstanding (not rated by ICRA) as on December 31, 2018. The bank's ability to service these bonds remains contingent on its meeting the regulatory capital requirements and reporting profits (including retained earnings). IB's distributable reserves (DRs), as a percentage of RWA, remain strong with DR/RWA of 9.19% as on December 31, 2018 compared to 9.26% as on December 31, 2017. With expectations of continued and improved internal accruals in FY2020, ICRA expects DR/RWA to remain strong at ~9.0% in FY2020.

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[3] Regulatory capital ratios under Basel III are CET I, Tier I and CRAR of 7.375%, 8.875% and 10.875%, respectively, as on March 31, 2019 (including the capital conservation buffer (CCB) of 1.875%); from March 31, 2020, the CCB requirement would increase by 0.625%

Established presence in southern India with growing retail franchise aiding absolute CASA growth – IB has a long-standing presence and established franchise in South India. Its CASA deposits grew at 7% YoY to Rs. 78,461 crore as on December 31, 2018, comparable to the average CASA growth of 6.7% YoY for PSBs for the period ended December 2018. The growth was driven by higher growth in SA deposit growth at 9% YoY. However, as the overall deposit base grew faster (supported by higher growth in term deposits), the share of CASA in total deposits declined to 35.73% as on December 31, 2018 from 36.55% as on December 31, 2017, remaining below the average CASA share of ~38.6% for PSBs. With the bank pursuing strong credit growth, the term deposits grew at a faster pace (~11% YoY), with term deposits of a ticket size of more than Rs. 5 crore growing at ~30% YoY. Despite its CASA share being lower than the PSB average, IB's cost of interest-bearing funds for Q3 FY2019 remained comparable at 5.17% against the PSB average of 5.19%. The bank's deposit base is supported by its network of 2,839 branches as on December 31, 2018, with 103 branches being added since December 31, 2017. With the management guiding towards the addition of 100-150 branches every year until FY2023, IB's retail franchise should strengthen, thereby boosting its liability profile.

Credit challenges

Deterioration in asset quality on account of large ticket slippages; incremental slippages expected to ease, and asset quality expected to improve, going forward – IB's asset quality profile has weakened since the last rating exercise with its fresh slippage rate for 9M FY2019 increasing sharply to 4.8% (annualised) from 2.2% (annualised for 9M FY2018). This also remained higher than the slippage rate of 4.1% in FY2018. The slippages in 9M FY2019 can be attributed to large ticket corporate slippages (including exposure to a leading infrastructure NBFC) and some MSME slippages. However, the management has guided towards moderation in the MSME slippages going forward, aided by the RBI's restructuring scheme for MSMEs. While recoveries and upgrades improved to Rs. 1,537 crore (12.8% of gross NPA) in 9M FY2019 from Rs. 788 crore (8.0% of gross NPA) in 9M FY2018, the gross NPA increased to Rs. 13,198 crore (7.46%) as on December 31, 2018 from Rs. 9,595 crore (6.27%) as on December 31, 2017 because of high slippages. With recent slippages and low provision for these slippages, the overall PCR for the stock of GNPAs declined to 42.64% as on December 31, 2018 from 48.95% as on December 31, 2017. Thus, with increased gross NPA and a decline in the provision cover, the bank's net NPA increased to Rs. 7,571 crore (4.42%) as on December 31, 2018 from Rs. 4,889 crore (3.30%) as on December 31, 2017. With higher net NPAs, IB's solvency profile has also weakened, with net NPA/net worth weakening to 46.3% as on December 31, 2018 from 31.4% as on December 31, 2017, although it remains marginally better than peer rated banks.

As per the guidance provided by the management, IB had an SMA-2[4] book outstanding of ~Rs. 4,500 crore (2.5% of gross advances) as on December 31, 2018. Additionally, the standard restructured advances book stood at Rs. 1,590 crore (0.90%) as on December 31, 2018. These represent potential sources of slippages over the next few quarters and have been incorporated in ICRA's estimates. ICRA expects a slippage rate of 2-3%. Based on this and with a provision cover (without TWO) of 68-70% for FY2020, ICRA expects the NPPAs to fall below 3% by March 31, 2020. With lower NPAs and higher net worth (due to improved internal capital generation), the solvency (net NPA/net worth) is expected to improve to 26-29% by March 31, 2020 from ICRA's estimated level of ~42% as on March 31, 2019.

Profitability may remain impacted by high credit costs but is expected to improve, going forward – IB's earnings profile weakened in 9M FY2019 with the profit after tax (PAT) declining to Rs. 512 crore (0.27% of ATA) from Rs. 1,127 crore (0.65% of ATA) in 9M FY2018. This was largely due to the higher credit costs (due to elevated slippages) and lower

[4] *SMA stands for special mention account and is bucketed into three categories - SMA0 (overdue by 1-30 days), SMA1 (overdue by 31-60 days) and SMA2 (overdue by 61-90 days)*

contribution from treasury. The credit costs for 9M FY2019 stood at 1.11% of ATA, higher than credit costs for corresponding period in FY2018. Further, due to the hardening of bond yields in H1 FY2019, the contribution from treasury gains remained muted at Rs. 80 crore in 9M FY2019 against Rs. 656 crore in 9M FY2018.

The bank's net interest income (NII) grew at 14% to Rs. 5,255 crore in 9M FY2019 from Rs. 4,626 crore in 9M FY2018 and was limited by high interest reversals as IB witnessed elevated slippages during this period. With stable cost of interest-bearing funds and income reversals being offset by interest recovery on NPA accounts, NIMs remained stable at 2.74% in 9M FY2019 (2.70% in 9M FY2018). IB's operating expenses increased to Rs. 2,933 crore (1.53% of ATA) in 9M FY2019 from Rs. 2,704 crore (1.58% of ATA) in 9M FY2018 due to increased overhead charges (resulting from branch expansion) and higher employee expenses (on account of wage revision). Despite the growth in operating expenses, the higher growth in NII and stable non-interest income, the bank's operating profit (before provisions and treasury gains) increased to Rs. 3,556 crore in 9M FY2019 compared to Rs. 3,196 crore in 9M FY2018.

As the bank's operating profitability remains satisfactory and with the standard assets expected to grow, ICRA expects IB's profitability to improve going forward. However, the extent of improvement will be driven by the provision cover maintained by the bank on its stressed assets. Even if the PCR increases to 68-70%, ICRA expects the credit provisions to be moderate in the range of ~1.9-2.3% of net advances (~1.2-1.4% of ATA) in FY2020. PAT/ATA is expected to improve marginally to 0.3-0.4% in FY2020 compared to 0.27% of ATA in 9M FY2019.

Liquidity position

According to the bank's structural liquidity statement (SLS) as on November 30, 2018, the negative cumulative mismatches were limited to ~1.2% of total outflows in the 6 months-1 year maturity bucket. Supported by a strong core deposit profile, a growing retail franchise and excess SLR holdings of ~7% on net demand and liabilities (on an average fortnightly basis during July 2018-December 2018), ICRA expects the bank to maintain an adequate liquidity profile. IB's liquidity coverage ratio (LCR)[5] remained adequate at 119.18% against the minimum regulatory requirement of 90%, as on December 31, 2018. ICRA draws further comfort from the liquidity support available to the bank from the RBI (through reverse repo against excess SLR investments and the marginal standing facility line), which can be availed in case of urgent liquidity needs.

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	The rating factors in IB's sovereign ownership and support from the GoI, if required
Consolidation/Standalone	To arrive at the rating, ICRA has considered IB's standalone financials

[5] *LCR requirement has increased to 100% from January 1, 2019*

About the company

Indian Bank is the eighth largest PSB (in terms of asset base) with a majority shareholding by the GoI (81.49% as on March 31, 2019). As of December 31, 2018, the bank's network comprised 2,842 branches and 3,787 ATMs.

The bank reported PAT of Rs. 512 crore in 9M FY2019 against PAT of Rs. 1,127 crore in 9M FY2018. Its asset base stood at Rs. 2,61,160 crore as on December 31, 2018 against Rs. 2,41,405 crore as on December 31, 2017. The asset quality indicators, i.e., the GNPA and NNPA stood at 7.46% and 4.42%, respectively, as on December 31, 2018 against 6.27% and 3.30%, respectively, as on December 31, 2017 and 7.16% and 4.23%, respectively, as on September 30, 2018. IB's capital ratios, i.e., CET I, Tier I and CRAR were 10.92%, 11.24% and 12.67%, respectively, as on December 31, 2018 against the minimum regulatory requirement of 7.375%, 8.875% and 10.875%, respectively.

Key financial indicators - Standalone (audited)

	FY2017	FY2018	9M FY2018	9M FY2019
Net Interest Income	5,146	6,264	4,626	5,255
Profit before Tax	1,758	1,076	1,459	678
Profit after Tax	1,406	1,259	1,127	512
Net Advances	1,27,699	1,56,569	1,48,274	1,71,157
Total Assets	2,15,533	2,50,094	2,41,405	2,61,160
% CET 1	11.82%	11.00%	10.64%	10.92%
% Tier 1	12.20%	11.33%	10.99%	11.24%
% CRAR	13.64%	12.55%	12.44%	12.67%
% Net Interest Margin / Average Total Assets	2.47%	2.69%	2.70%	2.74%
% Net Profit / Average Total Assets	0.68%	0.54%	0.65%	0.27%
% Return on Net Worth	10.06%	8.27%	9.94%	4.24%
% Gross NPAs	7.47%	7.37%	6.27%	7.46%
% Net NPAs	4.39%	3.81%	3.30%	4.42%
% Provision Coverage (excl. technical write-offs)	43.17%	50.29%	48.95%	42.64%
% Net NPA / Net Worth	38.77%	37.66%	31.39%	46.34%

Total assets and net worth exclude revaluation reserves
Note: Amounts in Rs. crore; all calculations are as per ICRA
Source: Indian Bank, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Type	Amount rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating	Chronology of Rating History for the Past 3 Years		
				FY2020	FY2018	FY2017	FY2016
				Apr-19	Jan-18	Sep-16	Feb-16
Lower Tier II Bonds	LT	500	500	[ICRA]AA+ (Positive)	[ICRA]AA+ (positive)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)

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 No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE562A09030	Lower Tier II Bonds	28-Jun-10	8.53%	28-Jun-20	500.00	[ICRA]AA+ (positive)

Source: Indian Bank

ANALYST CONTACTS

Mr. Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Mr. Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Mr. Shashank Singh
+91 124 4545 386
shashank.singh@icraindia.com

RELATIONSHIP CONTACT

Mr. Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
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