ICRA

September 19, 2019

# Indian Bank: Rating placed on Watch with Developing Implications

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Basel II Compliant Lower Tier II Bonds Programme | 500.00 | 500.00 | [ICRA]AA+ &; Placed on rating Watch with Developing Implications |
| **Total** | **500.00** | **500.00** | |

*& Under Rating Watch with Developing Implications*
**Instrument details are provided in Annexure-1*

## Rationale

On August 30, 2019, the Government of India (GoI) announced the merger of 10 public sector banks (PSBs) into four entities with a proposed capital infusion of Rs. 59,807 crore into 11 banks[1] and measures to improve the corporate governance standards in banks.

As a part of the announcement, the GoI proposed the merger of Indian Bank and Allahabad Bank (rated [ICRA]A1+). Upon implementation, the merger is expected to create the seventh-largest PSB in India in terms of business (net advances and deposits) of Rs. 7.76 lakh crore (as on June 30, 2019). Further, while the Ministry announced a proposed capital infusion of Rs. 2,500 crore for Indian Bank, no capital support was announced for Allahabad Bank. The amalgamated entity (Indian-M) would have an improved scale with a 3.6% share in net advances and a 3.7% share in total deposits as on June 30, 2019. Moreover, Indian-M would have a wider geographical presence as Indian Bank has a strong presence in South India while Allahabad Bank has an established retail franchise with a dominant presence in eastern India. Both banks use the same core banking solution (CBS) platform, BaNCS, which shall result in better realisation of operational synergies that are expected to accrue only over the medium term.

Indian Bank remains relatively better capitalised among various PSBs with a Tier I capital of 11.72% and NNPA/CET of 38.8% compared to the PSB average of 9.8% and 61%, respectively, as on June 30, 2019. Indian Bank's asset quality is also relatively better with NNPA of 3.84% compared to the PSBs' average of 5.0% as on June 30, 2019. Accordingly, as per ICRA's estimates, Indian Bank's capital requirements for growth remain limited. Supported by a large capital infusion of Rs. 11,470 crore in FY2019, Allahabad Bank reduced its NNPAs to 5.22% as of March 2019 with Tier I of 9.68% and NNPA/CET of 59% as on March 31, 2019 compared to 8.04%, 6.69% and 151%, respectively, as on March 31, 2018.

Based on the merged financials of Indian Bank and Allahabad Bank, the combined entity's NNPAs stood at 4.68% and solvency was 50% as on June 30, 2019, better than the PSBs' average. The combined entity reported a net profit of Rs. 493 crore (return on assets - RoA of 0.38%) in Q1 FY2020.

In ICRA's view, with an 8-10% growth in risk-weighted assets (RWAs), the merged entity will continue to maintain comfortable capital cushions over the regulatory levels without any need for fresh capital raise in FY2020, even though

[1] *GoI subsequently announced a capital infusion of Rs. 4,557 crore in IDBI Bank Limited ((rated [ICRA]A(Negative) for Tier II bonds))*

the internal capital generation is expected to remain weak with RoA of 0.2-0.3%. ICRA expects the merged entity to be able to reduce its stock of NNPAs further and improve its solvency profile by March 2020.

The current account and savings account (CASA) deposit base for the merged entity is estimated at ~40% of total deposits, which is driven by the high CASA deposits base of Allahabad Bank. The increased CASA base should positively impact the cost of funds, thus driving profitability.

While the boards of both banks have accorded in-principle approval to the merger, the merger process is still in a nascent stage. Given the initial stage of the proposed merger, ICRA has placed the rating under Watch with Developing Implications and will take appropriate rating action as and when more clarity emerges on the capital position and solvency profile of the merged entity.

## Key rating drivers and their description – NA

For the previous rationale of Indian Bank – Click here

## Liquidity position: Strong

Supported by excess SLR holdings of ~4.5% of total deposits as on June 30, 2019, Indian Bank's liquidity coverage ratio (LCR) stood at 125.51% as on June 30, 2019 (on a daily weighted average basis in Q1 FY2020), above the regulatory requirement of 100%. As per the latest structural liquidity statement (SLS) available with ICRA, bank's negative cumulative mismatches were limited to ~1.2% of total outflows in the 1-year maturity bucket. 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.

## Rating sensitivities

**Positive triggers** – ICRA could assign a Positive outlook and/or upgrade the rating if the merged entity is able to reduce and maintain its NNPAs at less than 4% while improving the solvency (NNPA/CET) to <40% and maintaining a capital cushion of ~1% over the regulatory capital ratios on a consistent basis.

**Negative triggers** – ICRA could assign a Negative outlook and/or downgrade the rating if the merged entity's NNPAs exceed 5% with a weak solvency profile of NNPA/CET >60% on a sustained basis.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | ICRA Rating Methodology for Banks<br>Impact of Parent or Group Support on an Issuer's Credit Rating |
| Parent/Group Support | Parent/Group Company: Sovereign ownership<br>The rating factors in Indian Bank's sovereign ownership and demonstrated track record of capital infusion by the GoI |
| Consolidation/Standalone | To arrive at the rating, ICRA has considered the standalone financials of Indian Bank and Allahabad Bank |

## About the company

Indian Bank is the eighth-largest PSB (in terms of asset base) with a majority shareholding by the GoI (79.62% as on June 30, 2019). As of June 30, 2019, the bank's network comprised 2,875 branches (of which 3 are overseas branches) and 3,885 ATMs.

Indian Bank reported a profit after tax (PAT) of Rs. 365 crore in Q1 FY2020 against PAT of Rs. 209 crore in Q1 FY2019. Its asset base stood at Rs. 2.79 lakh crore as on June 30, 2019 against Rs. 2.48 lakh crore as on June 30, 2018. The asset quality indicators, i.e., the GNPA and NNPA stood at 7.33% and 3.84%, respectively, as on June 30, 2019 against 7.20% and 3.79%, respectively, as on June 30, 2018 and 7.11% and 3.75%, respectively, as on March 31, 2019. India Bank's capital ratios, i.e., CET I, Tier I and CRAR were 11.40%, 11.72% and 13.62%, respectively, as on June 30, 2019, against the minimum regulatory requirement of 7.375%, 8.875% and 10.875%, respectively.

## Key financial indicators (audited) – Indian Bank

| | FY2018 | FY2019 | Q1 FY2019 | Q1 FY2020 |
|---|---|---|---|---|
| Net interest income | 6,264 | 7,018 | 1,807 | 1,785 |
| Profit before tax | 1,038 | 284 | 268 | 579 |
| Profit after tax | 1,259 | 322 | 209 | 365 |
| Net advances | 156,569 | 181,262 | 158,433 | 177,581 |
| Total assets | 250,094 | 276,970 | 248,133 | 278,545 |
| | | | | |
| % CET I | 11.00% | 10.96% | 11.22% | 11.40% |
| % Tier I | 11.33% | 11.29% | 11.55% | 11.72% |
| % CRAR | 12.55% | 13.21% | 12.77% | 13.62% |
| | | | | |
| % Net interest margin | 2.69% | 2.66% | 2.90% | 2.57% |
| % PAT / ATA | 0.52% | 0.12% | 0.34% | 0.53% |
| % Return on net worth | 8.06% | 2.92% | 5.25% | 8.87% |
| | | | | |
| % Gross NPAs | 7.37% | 7.11% | 7.20% | 7.33% |
| % Net NPAs | 3.81% | 3.75% | 3.79% | 3.84% |
| % Provision coverage excl. technical write-offs | 50.29% | 49.13% | 49.28% | 49.49% |
| % Net NPA/ CET | 35.4% | 40.5% | 35.6% | 38.8% |

*Note: Amount in Rs. crore; Net worth and total assets exclude revaluation reserves*
*Source: Indian Bank, ICRA research*
*All calculations are as per ICRA research*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| | | Rating (FY2020) | | | | | | Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|---|---|
| S. No. | Instrument | Type | Amount Rated | Amount Outstanding | Current Rating 19-Sep-2019 | Earlier Rating 29-Apr-2019 | FY2018 12-Jan-2018 | 31-Jul-2017 | FY2017 27-Sep-2016 | FY2016 23-Feb-2016 |
| 1 | Lower Tier II Bonds | LT | 500.00 | 500.00 | [ICRA]AA+ & | [ICRA]AA+ (Positive) | [ICRA]AA+ (Positive) | [ICRA]AA+ (Positive) | [ICRA]AA+ (Positive) | [ICRA]AA+ (Positive) |

*& Rating Watch with Developing Implications*
*Amount in Rs. Crore*

## 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 | 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+ & |

*& Rating Watch with Developing Implications*
*Source: Indian Bank*

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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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