

## Allahabad Bank

September 10, 2018

### Summary of rated instrument

Instrument*	Previous Rated Amount (Rs Crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificate of Deposit Programme <i>*Instrument details are provided in Annexure-1</i>	20,000.00	20,000.00	[ICRA]A1+; reaffirmed

### Rating action

ICRA has reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating for the Rs. 20,000-crore certificate of deposit programme of Allahabad Bank (AB)<sup>1</sup>.

### Rationale

The rating reaffirmation factors in the majority sovereign ownership coupled with the bank's comfortable liquidity profile. The bank has a high share of low cost current account and savings account (CASA) deposits compared to the public sector banks' (PSBs) average. This supports its liquidity profile and resulted in lower cost of funds. The higher CASA deposit base is primarily due to a strong branch presence, mainly in the eastern and central regions of India. Further, the bank's asset liability maturity (ALM) is comfortable with positive cumulative gaps across buckets supported by an excess statutory liquidity ratio (SLR) of ~7.2% of its net demand and time liabilities (NDTL) as on June 30, 2018, thereby supporting its positive ALM profile.

ICRA also considers AB's weak capital ratios as the bank continued to report a capital adequacy ratio (CRAR) below the regulatory minimum levels (excluding capital conservation buffer – CCB) for the last two consecutive quarters. AB reported CET I, Tier I and CRAR of 4.79%, 4.88% and 6.88%, respectively, as on June 30, 2018 compared to 5.57%, 6.69% and 8.69%, respectively, as on March 31, 2018. These ratios were below the RBI's minimum requirement of CET I, Tier I and CRAR of 5.5%, 7.0% and 9.0% (excluding CCB<sup>2</sup>), respectively. The Government of India (GoI) supported five public sector banks (PSBs) in July 2018, with capital infusion of Rs. 11,336 crore to shore up their capital ratios. With CET I expected to be lower than 5.5%, AB was among these five PSBs and received an equity infusion of Rs. 1,790 crore. With this, the adjusted CET I is expected to have surpassed 5.5%, though the Tier I and CRAR ratios are expected to remain below the minimum RBI requirement of 7.0% and 9.0%, respectively. The weak capital ratios were primarily because of continued asset quality stress, which resulted in higher credit provisions thereby leading to capital erosion.

The bank has reported losses for three consecutive years and ICRA expects it to report a loss during FY2019 given its weak asset quality and additional actions imposed under the RBI's prompt corrective action (PCA) framework. The additional actions under the PCA restrict the expansion of AB's risk-weighted assets (RWAs). This, coupled with reducing exposure to unrated and high-risk advances, will further impair its operating profitability during FY2019 as the cost-to-income ratio may weaken further. The weakening core operating profitability will continue to impair the bank's ability to absorb credit provisions. Going forward, the extent of recoveries and upgrades from non-performing accounts will also be a key determinant of losses and further capital requirements for FY2019. In our base case scenario, the credit

<sup>1</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

<sup>2</sup> CCB required is 1.875% as on March 31, 2018 and 2.5% as on March 31, 2019

provisions are expected to surpass the core operating profits, thereby necessitating further capital infusion by the bank to meet the regulatory capital ratios. Hence, ICRA will continue to monitor AB's capital-raising activity and any deterioration in the liquidity position amid a weakening operating profile. ICRA may take an appropriate rating action in case of continued deterioration in these parameters.

In a scenario of a decline of ~5-10% in RWA during FY2019, depending on credit provisions and losses, ICRA expects that the bank will require sizeable capital of ~Rs. 2,000-3,700 crore (~45-84% of its market capitalisation) during FY2019 to achieve a Tier I capital ratio (primarily CET I) of ~7.0% and CRAR of 9.0%. This is in addition to the GoI's capital infusion in July 2018. ICRA does not expect the bank to maintain the CCB in the near to medium term. However, the ability to maintain a CRAR of 9.0% is critical for servicing its debt capital instruments<sup>3</sup>, while adhering to the covenants for these instruments.

## Key rating drivers

### Credit strengths

**Majority sovereign ownership with demonstrated funding support** - The GoI held 71.81% equity in the bank, as on June 30, 2018. The GoI, which has demonstrated consistent capital support to the bank, infused Rs. 973 crore, Rs. 451 crore and Rs. 1,500 crore of equity capital during FY2016, FY2017 and FY2018, respectively. Further, the GoI infused Rs. 1,790 crore of equity in July 2018 with additional equity infusion expected during the current financial year under the recapitalisation plan.

**High CASA share compared to industry average resulting in lower cost of funds** - AB's total deposits grew by 3.2% on a YoY basis as on June 30, 2018, including CASA deposit growth of 5.0% YoY. This resulted in an improvement in the CASA ratio to 45.52% (June 30, 2018) from 44.74% (June 30, 2017). The growth in CASA deposits was primarily driven by 7.7% YoY growth in savings deposits (40.9% of total deposits), which was partially offset by 14.6% YoY de-growth in current deposits (4.6% of total deposits) as on June 30, 2018. AB's CASA ratio remains above the PSBs' average of ~37-38%. Around 61% of the bank's branches are concentrated in the rural and semi-urban segments, which supports the continued growth in the deposit base and the high share of CASA deposits. AB also reduced its high-cost bulk deposits by 48.4% YoY to Rs. 2,885 crore or 1.39% of total deposits as on June 30, 2018 from Rs. 5,585 crore or 2.77% of total deposits as on June 30, 2017. Further, the share of the top 20 depositors in total deposits declined to 5.2% as on March 31, 2018 from 9.8% as on March 31, 2014, indicating reducing dependence on the bulk institutional depositors. As a result, the bank's cost of deposits declined to 5.49% during Q1 FY2019 from 5.76% during Q1 FY2018. Going forward, with expected de-growth in advances, the deposit growth may remain muted and with natural growth in CASA deposits, the share of CASA deposits is expected to improve further, thereby benefiting the cost of interest-bearing funds.

**Comfortable liquidity profile** - AB has a favourable asset liability maturity with a positive mismatch in all time buckets as on June 30, 2018. Overall, the bank's short-term liquidity profile was comfortable with a positive cumulative gap of ~6.4% of the total outflows in the less than one-year bucket. The positive gaps were supported by an excess SLR of Rs. 15,085 crore (7.2% of NDTL), as on June 30, 2018, thereby supporting the bank's positive ALM profile.

### Credit challenges

**Capital ratios remain below regulatory levels; large capital requirement and high GoI dependence in FY2019 to meet capital ratios** - As expected, AB reported weak capital ratios with CET I, Tier I and CRAR at 4.79% (-78bps QoQ), 4.88% (-1.81% QoQ) and 6.88% (-1.81% QoQ), respectively, as on June 30, 2018 despite a 10.8% decline in RWAs on a QoQ basis.

<sup>3</sup> Such as Upper Tier II instruments and Tier I instruments issued under Basel II

The weakening in the capital ratios was mainly due to loss before tax of Rs. 1,933 crore during Q1 FY2019. The bank's capital ratios were below the minimum regulatory requirement of CET I, Tier I and CRAR (including CCB of 1.875%) at 7.375%, 8.875% and 10.875%, respectively, as on March 31, 2018. Even excluding the CCB requirement, the bank was unable to meet the RBI's minimum requirement of CET I, Tier I and CRAR of 5.5%, 7.0% and 9.0%, respectively, as on March 31, 2018. Further, AB exercised the early call option for the Tier I bonds in Q1 FY2019, amounting to Rs. 1,500 crore (1.16% of RWAs as on Q1 FY2019), under a regulatory event as the bank was placed under the PCA framework by the RBI. With CET I expected to fall below 5.5%, the GoI infused Rs. 1,790 crore in July 2018 under the recapitalisation plan, which is expected to have shored up the CET I above 5.5% (~6.17% as per ICRA's estimates). However, the Tier I and CRAR ratios remain below the minimum RBI requirement of 7.0% and 9.0%, respectively (6.26% and 8.26%, respectively, as per ICRA's estimates). The bank's board has approved the raising of Rs. 1,900 crore of equity capital to support its capital base. Given the expectations of weak financial performance during FY2019, the bank's ability to raise capital from external sources may be a challenge. In case AB is unable to raise capital from the markets, its dependence on the GoI for capital infusion is expected to remain high.

In a scenario of a decline of ~5-10% in RWA during FY2019, depending on credit provisions and losses, ICRA expects that the bank will require sizeable capital of ~Rs. 2,000-3700 crore (~45-84% of its market capitalisation) during FY2019 to achieve a Tier I capital ratio (primarily CET I) of ~7.0% and CRAR of 9.0%. This is in addition to the GoI's capital infusion in July 2018. ICRA does not expect the bank to maintain the CCB in the near to medium term. Management expects the capital ratios to improve with Tier I and CRAR above 7.0% and 9.0%, respectively, during FY2019. Going forward, if AB is unable to meet the CRAR of 9.0%, appropriate rating action may be taken.

**Additional actions under PCA framework to further impair profitability** - During January 2018, the RBI placed AB under the PCA framework due to high net NPA and negative return on assets (ROA) for two consecutive years based on its position as on March 31, 2017. ICRA notes that the bank's net NPA was 8.91% as on March 31, 2017 and the bank reported negative ROA of -0.32% and -0.13% during FY2016 and FY2017, respectively, making it fall under the threshold 1 category of the PCA framework. The financial position has not improved since March 2017 with continued losses during FY2018 and net NPAs remaining above the PCA threshold of 6.00% (7.32% as on June 30, 2018). Further, on May 14, 2018, the bank disclosed that the RBI has advised additional actions under PCA to AB, based on its CRAR and leverage ratio position. The actions were a) restrict RWA expansion, b) reduce exposure to unrated and high-risk advances, c) restrict creation of non-banking assets, and d) restrict access to or renewal of wholesale costly deposits or certificates of deposit. These restrictions will further constrain AB's banking operations and worsen its cost-to-income ratios and make it difficult for the bank to report profits during FY2019. ICRA expects the bank to post losses again during FY2019, which will result in a negative ROA for four consecutive years, which may put it in a higher-risk threshold under the PCA framework. ICRA expects that the bank is unlikely to exit the PCA framework by FY2020 and ability to report profitable operations and improvement in capital positions will be key triggers for exiting the PCA framework.

**Absence of top-level management (MD & CEO) to impact bank's operations** - On August 13, 2018, the GoI removed the MD & CEO of Allahabad Bank with immediate effect. Vacancy at a senior management level is likely to delay the bank's ability to come out of the PCA framework. Moreover, this may impact its ability to raise capital.

**Asset quality pain to continue during FY2019** - AB's absolute level of gross NPA (GNPA) declined on a sequential basis to Rs. 25,068 crore (15.97%) as on June 30, 2018 from Rs. 26,563 crore (15.96%) as on March 31, 2018. The fresh slippage rate remained high with slippages of Rs. 2,868 crore (8.2% on an annualised basis). Despite the high slippages, the decline in the stock of GNPA was supported by an improvement in cash recovery of Rs. 1,289 crore (+147.4% QoQ) and large write-offs of Rs. 1,239 crore (+56.2% QoQ). The GNPA ratio remained elevated at 15.97% as on June 30, 2018 (15.96% as on March 31, 2018) and remained above the PSB average. As per the RBI's Risk Assessment Report for FY2017, the bank had a GNPA divergence of Rs. 1,077.80 crore, resulting in lower reporting of provision by Rs. 152.40 crore. Therefore, the bank's losses for FY2017 would have been higher by Rs. 152.40 crore.

The provision coverage ratio, including technical write-offs, increased to 67.81% as on June 30, 2018 from 62.91% as on March 31, 2018 and 52.49% as on June 30, 2017. With a decline in the absolute level of GNPA's and a rise in the provision coverage ratio, the net NPA (NNPA) declined 14.9% on a QoQ basis to Rs. 10,410 crore as on June 30, 2018. As a result, the NNPA ratio declined to 7.32% as on June 30, 2018 from 8.04% as on March 31, 2018 and 8.96% as on June 30, 2017. Stressed assets (GNPA's + standard restructured) remained elevated at 16.70% as on June 30, 2018 compared to 16.53% as on March 31, 2018 and 16.53% as on June 30, 2017, which is above the PSBs' average. Further, the solvency level remained weak with NNPA's/net worth of 138% at the end of Q1 FY2019 (133% at the end of Q4 FY2018 and 106% at the end of Q1 FY2018) and was also weaker than the PSBs' average. ICRA expects the asset quality pain to continue during FY2019 as well and to weigh on profitability, although the absolute level of recovery and upgrade is expected to remain high compared to FY2018 driven by likely higher resolution of accounts referred under the National Company Law Tribunal (NCLT).

**Losses expected to continue mainly on account of weak asset quality** - The bank continued to report losses over the last three consecutive fiscal years with loss before tax of Rs. 6,591 crore during FY2018, Rs. 605 crore during FY2017 and Rs. 1,119 crore during FY2016. Further, AB reported a loss before tax of Rs. 1,933 crore (-3.15% of average total assets, ATA) during Q1 FY2019 compared to a loss before tax of Rs. 165 crore (-0.28% of ATA) in Q1 FY2018. The significant rise in losses was mainly due to a high provision of Rs. 2,985 crore (4.86% of ATA) during Q1 FY2019 and Rs. 10,029 crore (4.14% of ATA) during FY2018. The rise in provision was mainly due to NPA ageing coupled with the RBI's circular in February 2018, wherein the threshold for stress resolution was reduced to special mention account (SMA) status of the borrower, which resulted in early recognition of stress. AB's losses during Q1 FY2019 would have been higher by Rs. 458 crore had the bank not availed the RBI's dispensation of spreading the mark-to-market (MTM) loss on investments over four quarters.

Supported by recoveries from NPA accounts, the bank's operating profit (before provisions and treasury gains) increased to Rs. 1,153 crore (1.88% of ATA) during Q1 FY2019 from Rs. 838 crore (1.43% of ATA) during Q1 FY2018 and Rs. 155 crore (0.25% of ATA) during Q4 FY2018. The rise in operating profits was mainly because of an increase in net interest income (NII), and hence net interest margins (NIMs) increased to 2.77% of ATA during Q1 FY2019 from 2.12% during Q1 FY2018 and 1.44% during Q4 FY2018. The increase in interest income was mainly driven by interest recovery on NPA accounts during Q1 FY2019. The bank's operating expenses increased to Rs. 1,068 crore (1.74% of ATA) during Q1 FY2019 from Rs. 893 crore (1.53% of ATA) during Q1 FY2018 but declined from Rs. 1,248 crore (2.03% of ATA) during Q4 FY2018. As a result, the cost-to-income ratio improved to 48.1% during Q1 FY2019 compared to 51.6% during Q1 FY2018 and 89.0% during Q4 FY2018. AB's operating profits declined to Rs. 2,828 crore (1.17% of ATA) during FY2018 from Rs. 2,955 crore (1.26% of ATA) during FY2017 mainly on account of higher slippages leading to interest reversals though this was partially offset by the declining cost of funds and cost control.

Going forward, ICRA expects the bank's operating profitability to remain under pressure because of scaling down of operations. ICRA expects credit provisions to be ~3.3-4.3% of average net advances (or ~2.0-2.6% of ATA) during FY2019, which is likely to surpass the bank's core operating profitability, thereby resulting in losses. The extent of recoveries and upgrades from non-performing accounts will be a key determinant of the level of losses and capital required for FY2019.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:**

[ICRA Rating Methodology for Banks](#)

## About the company

Allahabad Bank (AB) was among the 14 banks that were nationalised in 1969. As on June 30, 2018, the GoI held 71.81% of the bank's equity. Around 61% of the bank's 3,243 domestic branches, as on June 30, 2018, are in rural and semi-urban areas, which resulted in a healthy base of low cost deposits (CASA at 45.52% as on June 30, 2018). For Q1 FY2019, the bank reported a net loss of Rs. 1,944 crore on an asset base<sup>4</sup> of Rs. 2,41,325 crore compared to a net profit of Rs. 29 crore on an asset base of Rs. 2,33,438 crore for Q1 FY2018. The bank reported a capital adequacy ratio of 6.88% (Tier I: 4.88%; both Basel III), and gross and net NPAs of 15.97% and 7.32%, respectively, as on June 30, 2018.

## Key financial indicators (audited) - Standalone

	FY2017	FY2018	Q1FY2018	Q1FY2019
Net interest income	5,287	4,732	1,243	1,704
Profit before tax	(605)	(6,591)	(165)	(1,933)
Profit after tax	(314)	(4,674)	29	(1,944)
Net advances	1,50,753	1,52,061	1,43,623	1,42,217
Total assets (excluding revaluation reserves)	2,34,437	2,50,157	2,33,438	2,41,325
% CET 1	8.20%	5.57%	8.32%	4.79%
% Tier 1	8.49%	6.69%	8.61%	4.88%
% CRAR	11.45%	8.69%	11.61%	6.88%
% Net interest margin / Average total assets	2.26%	1.95%	2.12%	2.77%
% Net profit / Average total assets	-0.13%	-1.93%	0.05%	-3.16%
% Return on net worth	-2.59%	-43.84%	0.95%	-92.89%
% Gross NPAs	13.09%	15.96%	13.85%	15.97%
% Net NPAs	8.91%	8.04%	8.96%	7.32%
% Provision coverage incl. technical write offs	50.11%	62.91%	52.49%	67.81%
% Net NPA/ Net worth	110.89%	132.76%	105.98%	138.18%

Amount in Rs. crore; Net worth excludes revaluation reserves

Source: Allahabad Bank; ICRA research

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

## Any other information: None

<sup>4</sup> Excluding revaluation reserve

### Rating history for last three years:

Sr. No.	Instrument	Current Rating (FY2019)			Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
1	Certificate of Deposits	Short Term	20,000.00	-	[ICRA]A1+ Sep 2018	[ICRA]A1+ May 2018	[ICRA]A1+ Aug 2017	[ICRA]A1+ Sep 2016	[ICRA]A1+ Dec 2015

### 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](http://www.icra.in)

## Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Allotment	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Certificate of Deposits	NA	NA	7-365 days	20,000.00 <sup>^</sup>	[ICRA]A1+

<sup>^</sup> There is no outstanding against the rated amount

Source: Allahabad Bank, ICRA research

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For more information, visit [www.icra.in](http://www.icra.in)

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