

National Bank for Agricultural and Rural Development

January 24, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	50,000.00	50,000.00	[ICRA]A1+; reaffirmed
Long-term Bonds Programme	3,146.00	3,146.00	[ICRA]AAA (Stable); reaffirmed
Total	53,146.00	53,146.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings take into account NABARD's sovereign ownership by the Government of India (GoI) at 100% as on March 31, 2018 and its strategic and supervisory role in India's agriculture and rural development sectors. The ratings favourably factor in the bank's sound asset quality indicators (gross NPA ratio at 0.04% and nil net NPAs as on September 30, 2018), comfortable capital profile (CRAR at 18.12% as on September 30, 2018), diversified funding profile and favourable liquidity position. NABARD is also engaged in the formulation and modification of policies related to the agricultural and rural development sectors.

ICRA also considers the bank's modest earnings profile with low return ratios (return on equity of 7.96% in H1 FY2019) driven by the cap on its lending margins. ICRA also takes note of the bank's exposure towards investment credit (medium-to-long-term refinance) to entities with relatively weak credit profiles, which is offset by guarantees from the concerned state government. However, ICRA notes that all the exposures to state government entities are not covered by state government guarantees. Due to low internal capital generation and high credit growth, NABARD remains dependent on regular capital infusion by the GoI for growth and for maintaining a prudent leverage level.

Outlook: Stable

ICRA believes that NABARD will continue to benefit from its important role as an apex financing and refinancing institution in the agricultural and rural sector of India, which enables it to get allocations under the Rural Infrastructure Development Fund (RIDF) and other funds as well, along with equity support from the GoI. The outlook may be revised to Negative if there is a dilution in its strategic role and importance to the GoI.

Key rating drivers

Credit strengths

Continued GoI support given NABARD's strategic and supervisory role in agricultural and rural sectors - NABARD's strategic significance to the GoI is reflected in the regular equity infusions (Rs. 300 crore in FY2016, Rs. 1,400 crore in FY2017, Rs. 3,880 crore in FY2018 and Rs. 2,000 crore in FY2019 till date) and its important role in the flow of credit to the agriculture and other rural sectors. NABARD supports the GoI's policy implementation related to the agriculture and rural sectors. Further, it acts as a supervisor and undertakes statutory inspections of state cooperative banks (StCBs), district central cooperative banks (DCCBs) and regional rural banks (RRBs) and conducts voluntary inspections of state cooperative agriculture and rural development banks (SCARDBs), apex cooperative societies and federations. NABARD is engaged in augmenting ground-level credit flow, which ensures capital formation in the agriculture and rural sectors. As

a part of future capital requirements, the Union Cabinet approved the amendments to the NABARD Act, 1981, enabling the GoI to increase the bank's authorised capital to Rs. 30,000 crore from Rs. 5,000 crore. The total capital infusion expected for FY2019 is Rs. 2,500 crore, which will enable NABARD to grow its credit book while maintaining leverage within regulatory levels.

Steady growth in advances; focus shifting towards long-term refinance loans and direct loans to improve profitability - NABARD's net advances grew by 15.5% YoY in FY2018 (17.1% YoY in FY2017) to Rs. 3,52,111 crore as on March 31, 2018 from Rs. 3,04,955 crore as on March 31, 2017. The overall credit is expected to grow by 22.1% YoY to round Rs. 4,30,000 crore by March 31, 2019.

The refinance portfolio stood at Rs. 1,89,806 crore (54% of net advances) as on March 31, 2018 compared to Rs. 1,78,716 crore (59%) as on March 31, 2017, while direct loans were Rs. 1,62,305 crore (46%) as on March 31, 2018 compared to Rs. 1,26,239 crore (41%) as on March 31, 2017. The decline in the share of the refinance portfolio was driven by a fall in credit towards production and marketing credit to Rs. 66,761 crore as on March 31, 2018 from Rs. 74,618 crore as on March 31, 2017. Meanwhile, the project loans refinance increased due to NABARD's decision to rationalise limits for short-term refinance owing to its lower spreads compared to project loans refinance. In FY2018, the long-term refinance portfolio grew by 18.3% YoY (20.2% YoY in FY2017) while the short-term refinance portfolio registered a degrowth of 10.5% YoY (growth of 6.3% YoY in FY2017).

Under direct loans, RIDF loans grew to Rs. 1,10,062 crore (9.0% YoY in FY2018 and 10.5% YoY in FY2017) and accounted for 31.3% of net advances as on March 31, 2018. RIDF loans are mostly guaranteed by state governments and are hence efficient from the asset quality as well as capital adequacy perspective. Other direct lending includes lending under the Long-Term Irrigation Fund (LTIF), which grew by 125% YoY to Rs. 20,447 crore in FY2018 (5.8% of the net advances) as on March 31, 2018 from 3% as on March 31, 2017. Under direct lending, NABARD also advanced loans to National Rural Infrastructure Development Authority (NRIDA) under the Pradhan Mantri Awas Yojana – Gramin (PMAY-G), that stood at Rs. 7,329 crore in FY2018 or ~2% of net advances. For lending under both these programmes, NABARD has also raised GoI fully serviced bonds totalling Rs. 12,622 crore till March 31, 2018 and these programmes are expected to drive the advances growth in FY2019 also.

All the above advances by NABARD are to government and quasi-government entities or banks including scheduled commercial banks (SCBs), StCBs, RRBs, and DCCBs.

Within direct lending, NABARD also lends to the private sector (excluding banks), which grew to Rs. 32,776 crore as on March 31, 2018 (~194% YoY) and accounted for 9.2% of net advances compared to Rs. 11,140 crore as on March 31, 2017 (3.6% of net advances). The lending to the private sector mainly includes microfinance institution (MFIs) and non-banking financial companies (NBFCs) and was estimated at ~ Rs. 30,000 crore as of December 2018.

Sound asset quality indicators - NABARD's asset quality remained stable with the gross NPA ratio in the range of 0.04% to 0.07% over the years. The gross NPA ratio improved marginally to 0.04% as on September 30, 2018 from 0.05% as on March 31, 2018, while net NPAs were nil as on September 30, 2018. NABARD reported nil net NPAs in both FY2017 and FY2018.

Recently, during the state elections, many state governments announced farm loan waivers. ICRA notes that NABARD does not have direct exposure to farm loans. However, the underlying credit profile of NABARD's borrowers such as co-operative banks and RRBs, among others, where NABARD undertakes refinancing activity may get negatively impacted. The impact of the above-mentioned factors on NABARD's asset quality will remain monitorable given the weak financial profile of some borrowers. The lending to these entities is governed by NABARD's internal guidelines on capital adequacy and the asset quality of the financial institutions. NABARD also undertakes regular inspection of these institutions and advises the stakeholders on corrective actions like capital infusion.

The RIDF loans are secured by an irrevocable letter of authority executed by the state government and registered with the Reserve Bank of India (RBI) for direct debit to the state government's account with the RBI, in case of any shortfall in repayments. Further, advances towards investment credit (medium-to-long-term refinance) to StCBs are made available against guarantees provided by the concerned state governments while refinance to SCARDBs was only against government guarantees. However, ICRA notes that all the exposures to state government entities are not covered by state government guarantees. Overall, these act as a credit risk mitigant for NABARD's advances to weak financial profile entities and help in maintaining sound asset quality. NABARD also has an investment exposure to IL&FS, which defaulted recently, though the exposure towards the same is limited.

Comfortable capitalisation - NABARD's capital adequacy ratio (CRAR) was comfortable at 18.12% as on September 30, 2018 (18.85% as on March 31, 2018), driven by satisfactory internal accruals, regular equity infusion by the GoI and low-risk weights on certain exposures. NABARD is currently complying with the RBI's Basel II regulations, which require a minimum CRAR of 9.0%. However, there is no clarity on the implementation and impact of the adoption of Basel III regulations by the bank. The management does not expect any major regulatory changes in the near future. Despite a comfortable CRAR, NABARD's leverage remained relatively high at 8.81 times as on September 30, 2018. This is because RIDF loans with state government guarantees carry zero-risk weights in the calculation of CRAR. ICRA also notes that the gearing was within the RBI's prescribed limits of leverage¹ of 11 times for the bank. With expected growth in advances, the leverage as on March 31, 2019 is expected to increase to over 9.1 times though it will remain within regulatory levels.

Diversified funding profile with rising share of market borrowings in net incremental funding - NABARD has a diversified funding profile with market borrowings accounting for 82% of total borrowings as on March 31, 2018 compared to 80% as on March 31, 2017. Borrowings through short-term sources such as commercial papers and certificates of deposit accounted for 21.2% of net incremental borrowings, bonds and debentures (8.2%), LTIF bonds (14.1%), GoI fully serviced bonds under LTIF and PMAY-G (17.9%) and RIDF deposits (18.5%), among others.

NABARD is also recognised by the GoI as a nodal agency for the mobilisation of low-cost RIDF deposits. It also raises funds under the Short Term Cooperative Rural Credit (STCRC) Fund and Long Term Rural Credit Fund (LTRCF) from commercial banks for covering the shortfall in their priority sector lending (PSL) targets. For funding the LTIF projects, as a part of market borrowings, NABARD raised additional LTIF bonds, which accounted for 3.8% of the total borrowings in FY2018, over and above the GoI (LTIF) fully serviced bonds. GoI fully serviced bonds under the PMAY-G scheme accounted for 1.8% of total borrowings in FY2018. With the overall funding needs under LTIF and PMAY-G being identified, these borrowings are expected to increase substantially in future. Given the quasi-sovereign status of NABARD, it mobilises funds at competitive rates from the capital markets as well, in the form of bonds, commercial papers and certificates of deposit. This resulted in low cost of average borrowings at 5.71% in FY2018 compared to 6.01% in FY2017.

¹Leverage is defined as total debt / net owned funds

Credit challenges

Modest earnings profile mainly driven by cap on lending margins – Despite a muted growth in net interest income (NII) by 30 bps YoY to Rs. 3,196 crore in H1 FY2019, NABARD reported net profit growth of 14.1% YoY to Rs. 1,607 crore mainly driven by a YoY decline of 32.3% in operating expenses. The muted growth in NII was due to a 15.2% YoY rise in interest income to Rs. 13,530 crore, which was partially offset by a rise in interest expenses by 21.0% YoY to Rs. 10,265 crore. This translated into profit after tax to average total assets (PAT/ATA) of 0.76% in H1 FY2019 compared to 0.78% in FY2018. This, coupled with a slight rise in gearing (8.81 times in H1 FY2019 from 8.69 times in FY2018), resulted in a marginal increase in the return on net worth (RoE) to 7.96% in H1 FY2019 from 7.73% in FY2018. Management informed that their exposure to IL&FS was in the form of investments of Rs. 225 crore (0.73% of total investments as of FY2018), which they have fully provided for in Q3 FY2019. The impact on FY2019 earnings is likely to be minimal due to the low exposure.

In FY2018, NABARD increased its stake in SIDBI, resulting in an increase in its investment in SIDBI to Rs. 966 crore from Rs. 48 crore in FY2017. Further, such buyouts may negatively impact the bank's return ratios in the near to medium term.

Moreover, the bank's net interest margin (NIM) and gross interest spreads remained low at 1.69% and 78 bps, respectively, in FY2018. NABARD's spreads remain low mainly on account of a cap on its lending margins such as 50 bps on RIDF advances (31.3% of net advances) and 60 bps on LTIF advances (5.8% of net advances). With internal capital generation being weaker than the growth in advances, the bank continues to require capital infusion for supporting growth.

Share of low-cost RIDF funds and impact on borrowing cost – The RIDF funds accounted for 28.6% of NABARD's total funding as on March 31, 2018 compared to 30.3% as on March 31, 2017. NABARD also receives funding through GoI fully serviced bonds under various schemes such as LTIF and PMAY-G. Further, there are a few schemes such as National Rural Livelihood Mission under which NABARD gets interest subvention from the GoI. In the interest subvention, NABARD's refinance rate is reduced from its cost of borrowing and the balance is contributed by the GoI. The RIDF funds, fully serviced bonds and interest subvention scheme allowed the bank to report a low cost of average borrowings between 5.7% and 6.3% during the last few years. However, if the PSL compliance of SCBs improves, thereby resulting in a decline in RIDF funds or the GoI's RIDF allocation to NABARD declines, the bank's cost of borrowings may increase. Similarly, if the fully serviced bonds and interest subvention schemes are not available to NABARD, its cost of borrowings may increase. Nevertheless, RIDF allocations have not seen a decline in the past. Hence, the cost of borrowing is expected to remain competitive.

Direct wholesale lending to state-level entities with relatively weak credit profile – NABARD's lending is concentrated to state governments (34.3% of net advances as on March 31, 2018), co-operative banks (20.1%), SCBs (15.5%), and RRBs (12.8%) with the top 20 borrowers accounting for ~50% of the advances as on March 31, 2018 compared to ~55% as on March 31, 2017. As some of the state-level entities, co-operative banks and RRBs have weak credit profiles, NABARD's exposure to weak counterparty risk remains. As per ICRA's estimates, the top 20 exposures are likely to include 11-12 state governments, 5-6 SCBs and 2-4 co-operative banks.

Continued dependence on capital infusion from GoI for growth and maintaining prudent leverage - ICRA notes that NABARD has been receiving regular equity infusion from the GoI over the last few years. This helps the bank to maintain growth, leverage and capital ratio levels. Further, NABARD is not required to pay dividend to the GoI, resulting in capital retention. Given the expected loan growth in the regular segments and an increase in LTIF and PMAY-G disbursements, NABARD's ability to maintain leverage will also depend on capital infusion from the GoI considering its weak internal capital generation in relation to growth requirements. As per NABARD's business plan, the expected leverage is likely to be over 9.1 times in FY2019 even though CRAR will remain comfortable. However, with limited headroom to increase leverage, NABARD will require continued capital from the GoI in future, depending on its business growth plans.

Liquidity position

NABARD has a comfortable asset liability profile with a positive cumulative mismatch in the short as well as the long term, except in the 29 days-to-3-months bucket. The cumulative gap in the 29 days-to-3-months bucket stood at 1.7% of total assets as on September 30, 2018. This gap can be funded by calling upon the PSL shortfall from banks that stood at Rs. 15,000 crore (one-month notice required). Also, NABARD had undrawn bank lines of Rs. 15,000 crore as on September 30, 2018 resulting in a comfortable liquidity profile.

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	ICRA expects NABARD's role as a public policy institution for the development of the agricultural and rural sectors of India to continue, which will enable it to access fund allocation and capital support from the GoI.
Standalone/Consolidated	For arriving at the ratings, ICRA has considered the standalone financials of NABARD. However, in line with its limited consolidation approach, ICRA has factored in the capital requirement of NABARD's subsidiaries, NABKISAN Finance Limited, NABSAMRUDDHI Finance Limited, NABARD Financial Services Limited and NABARD Consultancy Private Limited. ICRA notes that all four NABARD subsidiaries have limited scale of operations and are profitable. The capital requirements, if any, are likely to be insignificant in relation to NABARD's net owned funds (NOF) in the near to medium term.

About the company

National Bank for Agricultural and Rural Development (NABARD) was set up in 1982 through the NABARD Act, 1981, as an apex financial institution for the development and flow of credit to agriculture, small scale industries, cottage and village industries, rural sector, handicrafts and other rural crafts. NABARD also has a mandate to promote integrated and sustainable development of rural areas. It also frames policies and guidelines for rural financial institutions and provides financial assistance to various issuing financial institutions and banks through refinancing. NABARD also monitors the flow of ground-level rural credit. NABARD is wholly owned by the GoI, with effect from March 31, 2018.

Key financial indicators (audited) - Standalone

	FY2017	FY2018
Net interest income	5,822	6,362
Profit before tax	3,817	4,354
Profit after tax	2,646	2,962
Net advances	3,04,955	3,52,111
Total assets	3,48,260	4,06,642
%Tier 1	16.57%	17.65%
% CRAR	17.71%	18.85%
%Net interest margin / Average total assets	1.77%	1.69%
%Net profit / Average total assets	0.80%	0.78%
%Return on net worth	8.41%	7.73%
% Gross NPAs	0.05%	0.05%
% Net NPAs	0.00%	0.00%
% Net NPA/ Net worth	0.00%	0.00%

Amounts in Rs. crore

Source: NABARD, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Type	Current Rating (FY2019)		Chronology of Rating History for the Past 3 Years						
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jan 2019	Jul 2018	Jan 2018	Dec 2017	May 2017	Apr 2016	FY2015
1 Long-term bonds programme	Long Term	3,146.00	2,445.70 [^]	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2 Commercial paper	Short Term	50,000.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-

[^] Balance yet to be placed

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
NA	*Long-term bonds	NA	NA	NA	700.30	[ICRA]AAA(Stable)
INE261F09FG8	Long-term bonds	01-Jul-10	Zero Coupon^	01-Jul-20	47.71	[ICRA]AAA(Stable)
INE261F09FJ2	Long-term bonds	01-Aug-10	Zero Coupon^	01-Aug-20	125.00	[ICRA]AAA(Stable)
INE261F09FK0	Long-term bonds	01-Sep-10	Zero Coupon^	01-Sep-20	37.24	[ICRA]AAA(Stable)
INE261F09FL8	Long-term bonds	01-Oct-10	Zero Coupon^	01-Oct-20	67.98	[ICRA]AAA(Stable)
INE261F09FN4	Long-term bonds	01-Nov-10	Zero Coupon^	01-Nov-20	26.58	[ICRA]AAA(Stable)
INE261F09FQ7	Long-term bonds	01-Dec-10	Zero Coupon^	01-Dec-20	117.00	[ICRA]AAA(Stable)
INE261F09FS3	Long-term bonds	01-Jan-11	Zero Coupon^	01-Jan-21	40.54	[ICRA]AAA(Stable)
INE261F09FX3	Long-term bonds	01-Feb-11	Zero Coupon^	01-Feb-21	10.35	[ICRA]AAA(Stable)
INE261F09GC5	Long-term bonds	31-Mar-11	Zero Coupon^	01-Apr-21	73.30	[ICRA]AAA(Stable)
INE261F08444	Long-term bonds	10-Feb-15	8.18%	10-Feb-20	1,900.00	[ICRA]AAA(Stable)
NA	Commercial paper	NA	NA	7-365 days	50,000.00	[ICRA]A1+

*Unutilised; ^ With redemption premium resulting in promised return

Details as on December 31, 2018

Source: NABARD, ICRA research

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NABKISAN Finance Limited	80.40%	Limited Consolidation
NABSAMRUDDHI Finance Limited	78.83%	Limited Consolidation
NABARD Financial Services Limited	63.10%	Limited Consolidation
NABARD Consultancy Private Limited	100.00%	Limited Consolidation

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