

October 14, 2019

Allahabad Bank: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificates of Deposit Programme	20,000.00	20,000.00	[ICRA]A1+; reaffirmed
Total	20,000.00	20,000.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation takes into account the majority sovereign ownership and Allahabad Bank's (AB) comfortable liquidity profile. The liquidity profile is mainly supported by the high share of low-cost current account and savings account (CASA) deposits compared to the public sector banks' (PSBs) average. The higher CASA deposit base is primarily due to AB's strong branch presence, mainly in the eastern and northern regions of India. Further, the bank has excess statutory liquidity ratio (SLR) of ~4.7% of its net demand and time liabilities (NDTL), as on June 30, 2019, which supports its asset liability maturity (ALM) profile. AB's ALM profile is comfortable with positive cumulative mismatches (as a percentage of total outflows) in all the buckets up to 1 year, as on May 31, 2019, and the same has historically remained positive as well.

ICRA factors in the comfortable capitalisation profile, which is primarily due to the huge capital infusion of Rs. 11,740 crore by the Government of India (GoI) in FY2019. The bank reported CET I, Tier I and CRAR ratios of 9.68%, 9.71% and 12.55%, respectively, as on June 30, 2019, compared to the minimum regulatory requirement (including capital conservation buffer (CCB) of 2.5%) of 8.0%, 9.5% and 11.5%, respectively, as on March 31, 2020. With sizeable capital infusion, the bank increased its provision coverage ratio to ~80% (March 2019) from ~63% (March 2018), resulting in a decline in the net NPA (NNPA) ratio to 5.2% (March 2019) from 8.0% (March 2018), while maintaining its capital ratios above the regulatory levels. Consequently, in February 2019, AB exited the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework, driven by the improvement in its capital ratio and reduction in the NNPA ratios.

On August 30, 2019, the GoI announced the merger of AB with Indian Bank (rated [ICRA]AA+; Rating Watch with Developing Implications). 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). 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.

In ICRA's view, with 8-10% growth in risk-weighted assets (RWAs), the merged entity will continue to maintain comfortable capital cushions over the regulatory levels without any requirement for fresh capital raise in FY2020, even though the internal capital generation is expected to remain weak with return on assets (RoA) of 0.2-0.3%. ICRA expects the merged entity to be able to reduce its stock of NNPA's further and improve its solvency profile by March 2020. While the boards of both banks have accorded in-principle approval to the merger, the merger process is still in a nascent stage. ICRA expects that the merger is credit positive for AB.

Key rating drivers and their description

Credit strengths

Majority sovereign ownership with demonstrated funding support – The GoI has a majority equity stake of 92.01% in AB as on June 30, 2019. With the GoI being the majority shareholder, it has demonstrated capital support to the bank by infusing Rs. 1,500 crore in FY2018 and Rs. 11,740 crore in FY2019. On August 30, 2019, the 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 banks¹ as well as measures to improve the corporate governance standards of banks. As a part of the announcement, the GoI proposed the merger of AB with Indian Bank. 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 AB. The amalgamated entity (referred to as Indian-M henceforth) 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 AB has an established retail franchise with a dominant presence in eastern and northern 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.

With AB amalgamating with Indian Bank and given its comfortable capitalisation profile, ICRA does not expect AB to receive capital support from the GoI in FY2020.

Established retail franchise aids high CASA share and lower cost of funds vis-à-vis industry – AB has a well-established retail franchise, supported by a wide network of 3,229 branches as on June 30, 2019 with a strong presence in the eastern and northern states of India such as West Bengal, Bihar, Punjab and Uttar Pradesh (accounting for 58% of total branches). Supported by an established branch network, the bank has a large and steadily growing core deposit base, with low-cost CASA deposits growing 7.6% YoY to Rs. 1,01,947 crore as on June 30, 2019. The growth in CASA deposits was primarily driven by growth in savings deposits (7.2% YoY) as on June 30, 2019. Current deposits accounted for ~10% of overall CASA deposits compared to the PSB average of ~16% as on June 30, 2019. Around 61% of the bank's branches are concentrated in the rural and semi-urban segments, which supports continued growth in the deposit base and the high share of CASA deposits. AB's CASA share in total deposits remained higher at 47.85% as on June 30, 2019 compared to 45.52% as on June 30, 2018. Its CASA ratio remained above the PSBs' average of ~38-39%.

AB also reduced its high-cost bulk deposits², which remain limited at Rs. 2,751 crore or 1.29% of total deposits as on June 30, 2019 (Rs. 2,885 crore or 1.39% of total deposits as on June 30, 2018). Further, the share of the top 20 depositors in total deposits was limited at 4.3% as on March 31, 2019 (8.6% as on March 31, 2015), indicating reducing dependence on bulk institutional deposits. The increasing share of CASA deposits enabled AB to lower its cost of funds to 4.94% in Q1 FY2020 compared to the PSBs' average of 5.12%. Going forward, the deposit growth may remain muted at ~9-10%, given the expectation of ~8-10% growth in advances. CASA deposit growth is expected to remain in line with the overall deposit growth. Hence, the share of CASA deposits in total deposits is expected to remain stable.

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

² As per RBI guidelines, bulk deposits are defined as single deposits of Rs. 2 crore and above from March 2019; prior to that, bulk deposits were defined as single deposits of Rs. 1 crore and above

The CASA deposit base for the merged entity is estimated at ~40% of total deposits, driven by the high CASA deposit base of AB. The increased CASA base should positively impact the cost of funds, thus driving profitability.

Comfortable capitalisation profile post large capital infusion by GoI in FY2019 – Supported by a large capital infusion in FY2019 by the GoI, AB's capitalisation profile improved with CET I, Tier I and CRAR ratios at 9.68%, 9.71% and 12.55%, respectively, as on June 30, 2019, compared to 4.79%, 4.88% and 6.88%, respectively, as on June 30, 2018. In FY2019, AB received Rs. 11,740 crore from the GoI in three tranches – Rs. 1,790 crore in July 2018, Rs. 3,054 crore in November 2018 and Rs. 6,896 crore in March 2019. The last tranche helped the bank exit the PCA framework. The capital ratios were also supported by the reduction in AB's RWAs to Rs. 1.29 lakh crore (-0.16% YoY; -0.13% QoQ) as on June 30, 2019. In line with management's guidance, ICRA expects RWA growth of ~8-10% YoY by March 2020. The bank has become conscious of the incremental advances that attract higher RWAs and has reduced its RWAs/Advances to 90% as on June 30, 2019 from 104% as on March 31, 2017, to support its capital ratios. The capital optimisation was primarily driven by a rise in the share of retail advances (12.6% as on June 30, 2019 from 11.7% as on June 30, 2018). Further, the share of incremental retail advances to total incremental advances was 31% during June 2018 to June 2019. The capital optimisation was also due to the higher exposure towards better rated corporates with A and above rated corporates accounting for 52% of the total fund-based advances as on June 30, 2019 compared to 40% as on June 30, 2018. Also, the share of unrated exposures, which attract higher risk weights, declined to 28% of the total fund-based advances as on June 30, 2019 from 37% as on June 30, 2018. The incremental share of A and above rated fund-based exposures to total incremental fund-based advances was high at 312% during June 2018 to June 2019.

ICRA expects AB to remain well capitalised in FY2020 on a standalone basis. ICRA expects the bank's capital requirements to remain limited to ~Rs. 800 crore (~7% of its market capitalisation) with expected RWA growth of ~8-10% and Tier I capital ratio of 10.0% (assuming a cushion of 50 bps over the regulatory level).

Indian Bank also 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. Accordingly, as per ICRA's estimates, Indian Bank's capital requirements for growth remain limited. Hence, in ICRA's view, with 8-10% growth in RWAs, the merged entity will maintain comfortable capital cushions over the regulatory levels without any need for fresh capital raise in FY2020, given that the GoI has allocated Rs. 2,500 crore to Indian Bank in the recent round of capital allocation.

Credit challenges

Weak asset quality to continue with slippages to remain elevated in FY2020 – The absolute level of AB's gross NPA (GNPA) remained stable on a sequential basis at Rs. 28,703 crore (GNPA ratio of 17.44%) as on June 30, 2019 compared to Rs. 28,705 crore (17.56%) as on March 31, 2019. Excluding write-offs in Q1 FY2020, the GNPA's increased by 3.1% QoQ to Rs. 30,795 crore. The GNPA's are mainly accruing from the large industry segment (54.6% of total GNPA's; GNPA ratio of 34.2% within the sector), followed by agriculture (14.2%; 15.7%), MSME (13.8%; 15.5%), services (11.9%; 8.9%), retail (4.0%; 5.6%) and others (1.4%; 4.9%) as on June 30, 2019. The fresh slippage rate remains high for AB with gross slippages of Rs. 2,962 crore (8.79% slippage rate) in Q1 FY2020 compared to Rs. 2,826 crore (8.68% slippage rate) in Q4 FY2019 and is a credit concern. Slippages were mainly from the agriculture sector (38.1% of total slippages), MSME (26.4%) and large industry (18.3%), followed by retail (8.9%) and services (8.1%) in Q1 FY2020.

The provision coverage ratio (including technical write-offs) declined marginally to 78.58% as on June 30, 2019 from 79.85% as on March 31, 2019. With continued fresh slippages, the NNPA increased to Rs. 8,230 crore (NNPA ratio of 5.71%) as on June 30, 2019 from Rs. 7,419 crore (NNPA ratio of 5.22%) as on March 31, 2019.

AB's solvency level improved with NNPA/CET I of 66% at the end of Q1 FY2020 (168% at the end of Q1 FY2019 and 59% at the end of Q4 FY2019) but was weaker than the PSBs' average of ~61% at the end of Q1 FY2020. With high SMA-II advances to domestic advances of 3.37% as on June 30, 2019, and in line with management's guidance, ICRA expects gross fresh slippages to remain high in FY2020 (5-6% of net advances). However, given the comfortable capitalisation profile, ICRA estimates a high likelihood of the bank increasing its provision cover on GNPA's, thereby bringing down the NNPA% to 4.2-4.6% and solvency (NNPA/CET) to 50-51% by March 2020.

Indian Bank's asset quality is also relatively better with NNPA of 3.84% as on June 30, 2019. Based on the merged financials of Indian Bank and AB, the combined entity's NNPA's stood at 4.68% and the solvency (NNPA/CET) was 50% as on June 30, 2019, better than the PSBs' average. ICRA expects the merged entity to be relatively better placed on NNPA's and solvency with the same expected to be 2.8-3.0% and ~30%, respectively, by March 2020.

Profitability indicators expected to improve but remain weak in FY2020 – Despite a stable base of advances, AB reported a YoY decline of 10.2% in its net interest income (NII) in Q1 FY2020 as an NPA recovery was accounted as interest income in Q1 FY2019. Excluding this, the NII was higher by ~11% on a YoY basis in Q1 FY2020. AB's operating profit stood at 1.22% and 1.33%, respectively, of average total assets (ATA) in FY2019 and Q1 FY2020 and was lower than the PSBs' average of ~1.44%. This was because of the lower share of non-interest income as well as lower net interest margins, which resulted from the high level of NPAs and lower credit-to-deposit ratio.

With upfront provisioning in FY2019 to reduce NNPA's, AB reported a significant decline in credit provisions to Rs. 1,097 crore or 1.79% of ATA in Q1 FY2020 from 4.74% in FY2019. However, the provisions reported by the bank continue to be higher than the operating profits, resulting in a loss before tax of Rs. 149 crore in Q1 FY2020 compared to a loss before tax of Rs. 1,933 crore in Q1 FY2019 and Rs. 9,131 crore in FY2019. With high slippages expected to continue in FY2020, ICRA expects the bank's credit provisioning to remain high and profitability to remain weak in FY2020 also, even though it will be significantly better than FY2019.

On a combined basis, AB and Indian Bank reported a net profit of Rs. 493 crore (RoA of 0.38%) in Q1 FY2020. The internal capital generation is expected to remain weak with RoA of 0.2-0.3% in FY2020.

Liquidity position: Strong

As per the structural liquidity statement as on May 31, 2019, the bank had positive cumulative mismatches (as a percentage of total outflows) in all the buckets up to 1-year maturity. ICRA expects AB to maintain satisfactory liquidity, given the steady core deposit base (limited bulk deposits and granular depositor base) and considering its sovereign ownership. Supported by its established retail franchise and excess SLR holdings, AB's liquidity coverage ratio (LCR) remained adequate at 165% as on June 30, 2019 against the regulatory requirement of 100%. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity needs. AB held excess SLR of ~4.7% of the NDTL as on June 30, 2019, which provides further liquidity cushion.

Rating sensitivities

Positive triggers – Not applicable

Negative triggers – ICRA could downgrade the short-term rating in case of insufficient capital support from the GoI, leading to sustained capital breaches with CRAR of <9.0%. Additionally, the ability to maintain the depositor base and strong liquidity profile with limited asset liability mismatches will also be a rating driver.

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 AB's sovereign ownership and demonstrated track record of capital infusion by the GoI.
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of AB.

About the company

Allahabad Bank (AB) was among the 14 banks that were nationalised in 1969. The GoI held 92.01% of the bank's equity as on June 30, 2019. Around 61% of the bank's 3,229 domestic branches, as on June 30, 2019, are in rural and semi-urban areas, which resulted in a healthy base of low-cost deposits (CASA at 47.85% as on June 30, 2019). In Q1 FY2020, the bank reported a net profit of Rs. 128 crore on an asset base of Rs. 2,44,761 crore compared to a net loss of Rs. 1,944 crore on an asset base of Rs. 2,41,325 crore in Q1 FY2019. It reported a capital adequacy ratio of 12.55% (Tier I: 9.71%; both Basel III) and gross and net NPAs of 17.44% and 5.71%, respectively, as on June 30, 2019.

Key financial indicators (audited)

	FY2018	FY2019	Q1 FY2019	Q1 FY2020
Net interest income	4,732	5,511	1,704	1,530
Core operating profits	2,828	3,034	1,153	816
Credit provisions	10,326	11,761	2,494	1,097
Profit before tax	(6,591)	(9,131)	(1,933)	(149)
Profit after tax	(4,674)	(8,334)	(1,944)	128
Net advances	1,52,061	1,42,212	1,42,217	1,44,130
Total assets (excluding revaluation reserves)	2,50,105	2,45,632	2,41,325	2,44,761
% CET I	5.57%	9.65%	4.79%	9.68%
% Tier I	6.69%	9.68%	4.88%	9.71%
% CRAR	8.69%	12.51%	6.88%	12.55%
% Net interest margin / Average total assets	1.95%	2.22%	2.77%	2.50%
% Net profit / Average total assets	-1.93%	-3.36%	-3.16%	0.21%
% Return on net worth	-43.84%	-74.76%	-92.89%	3.89%
% Gross NPAs	15.96%	17.56%	15.98%	17.44%
% Net NPAs	8.04%	5.22%	7.32%	5.71%
% Provision coverage incl. technical write-offs	62.91%	79.85%	67.81%	78.58%
% Net NPA/ CET	151.26%	59.44%	167.90%	65.78%

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

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018	FY2017
					14-Oct-2019	10-Sep-2018	24-May-2018	28-Aug-2017	15-Sep-2016
1	Certificates of Deposit	Short Term	20,000.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

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
-	Certificates of Deposit	NA	NA	7-365 days	20,000.00 [^]	[ICRA]A1+

[^] There is no outstanding against the rated amount

Source: Allahabad Bank, ICRA research

Annexure-2: List of entities considered for consolidated analysis - Not applicable

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