India Ratings & Research
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India Ratings Affirms Indian Bank at 'IND AA+'/Stable; Off RWE

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India Ratings and Research (Ind-Ra) has affirmed Indian Bank's (IB) Long-Term Issuer Rating at 'IND AA+' while resolving the Rating Watch Evolving (RWE). The Outlook is 'Stable'. The Short-Term Issuer Rating has been affirmed at 'IND A1+'. The instrument-wise rating actions are given below:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating	Rating Action
Basel III Tier 2 bonds	-	-	-	INR25	IND AA+/Stable	Affirmed; off RWE
Certificate of deposits	-	-	1-365 days	INR120	IND A1+	Affirmed

Analytical Approach: Ind-Ra had placed IB's ratings on RWE on 4 September 2019, following the finance ministry's announcement on the proposed amalgamation of Allahabad Bank (ALBK) with IB, with the latter being the anchor bank post amalgamation. Subsequently, with all the necessary regulatory approvals having been received, the amalgamation has become effective from 1 April 2020.

The RWE resolution reflects the increase in IB's systemic importance post its amalgamation with Allahabad Bank and the continued support from the government of India (GoI), given its majority shareholding (88.06%, at end-June 2020). Post the amalgamation, the bank's total deposit and net advances market share has increased sharply. While the bank has received periodic equity support from GoI, Ind-Ra expects the bank's asset quality and capital buffers to be under pressure over FY21-FY22 on account of the incremental provisioning requirement, apart from ageing provisions due to the challenging macro-economic environment. IB's asset quality, the provisioning requirements, its capital position; and the GoI's consequent stance and actions towards the bank continue to be key monitorables.

KEY RATING DRIVERS

Systemic Importance Increases with Amalgamation: IB's systemic importance has augmented post the amalgamation with ALBK, with its market share in total deposits and net advances being about 3.7% (FY19: 2.0%) and 3.8% (2.0%), respectively, in FY20, making it the seventh-largest public sector bank (PSB) even after the announcement of amalgamations for other PSBs. The bank also has a sizeable network of about 6,062 domestic branches, 4,816 ATMs and cash recyclers, and a large customer base of 104 million.

Strong Capitalisation; Significantly Better than Peers: IB continues to be one of the most well-capitalised PSBs with a common equity tier 1 (CET1) ratio of 10.3% in 1QFY21 and a total capital adequacy ratio of 13.45% which the agency considers to be sufficient for near-term growth. The CET level is the highest amongst comparable peers despite IB (pre-amalgamation) receiving relatively lower capital infusions from the GoI during FY14-FY20. The agency estimates that the capital ratios on a post amalgamated basis are likely to be under pressure in the near term due to provisioning requirements; however, the agency estimates there will be sufficient buffers to maintain the capital ratios above the regulatory requirements. Furthermore, IB also has a board-approved plan for raising capital of INR50.0 billion through the issuance of additional tier I and tier II bonds. If this is achieved, it could add about 165bp to the total capital adequacy of the bank.

Amalgamation to Add Strength to Liability Franchise: Even prior to the amalgamation, IB had a higher share of low-cost current account and savings account (CASA) deposits in its total deposits profile (34.8% in 4QFY20 pre-amalgamation) than its comparable peers that have a sizeable presence in southern India. The amalgamation with ALBK has further strengthened IB's liability franchise, as ALBK had a high share of CASA in its deposit profile. On a combined basis, the CASA ratio for the amalgamated entity was at 41.5% in 1QFY21, which would place it well ahead of most of its larger peers among PSBs. IB aims to increase it to 45.0% in the near-to-medium term which will lead to an improvement in its cost of funds.

High Provision Coverage Ratio (PCR) on an Amalgamated Basis Provides Cushion: In its FY21 Mid-Year Banking Outlook, Ind-Ra had highlighted that around 7.7% of the total bank credit at end-March 2020 could come under restructuring from corporate and non-corporate segments. With the prevailing COVID-19 pandemic situation, the agency believes certain corporate sectors would be impacted severely despite borrowers opting for debt moratorium. Ind-Ra also believes the weakening economy (gross domestic product likely to contract 11.8% in FY21) could result in continuing pressure on asset quality for the overall banking industry.

IB has indicated that about 23% of its term loan customers, by value of loan book, had availed the Reserve Bank of India's prescribed moratorium at end-June 2020. For the purpose of its analysis, Ind-Ra has estimated that around 10% of the bank's net advances would come under restructuring; this is significantly higher than the management's expectations. Also, the agency believes that the need for restructuring will largely arise in the retail and micro, small and medium enterprises segments, wherein the impact of COVID-19-led lockdown has been more severe. The agency also believes the stressed assets that were not eligible for restructuring could subsequently slip into non-performing assets (NPAs), thereby increasing the provisioning requirement in the near term.

IB's gross NPA and net NPA stood at 10.9% and 3.8% in 1QFY21 (on amalgamated basis, 4QFY20: 11.4% and 4.2%, 1QFY20: 12.1% and 4.7%), relatively lower than most of its PSB peers. On an amalgamated basis, the PCR of 68.1% in 1QFY21 (on amalgamated basis, 4QFY20: 66.0% and 64.4% in 1QFY20) provides comfort against any near-term shocks. Furthermore, the special mention accounts-2 pool stood at INR31.1 billion, constituting 0.9% of the net advances, lower than the levels reported by most of its peers.

Liquidity Indicator - Adequate: On an amalgamated basis, IB's short-term (one year) asset-liability surplus stood at 8.4% at end-1QFY21. Its liquidity coverage ratio, at 159.3% in 1QFY21, was well above the regulatory requirement of 80%. Also, the bank maintains around 24.4% of its total assets in balances with the Reserve Bank of India and in government securities, which gives the agency comfort that the bank will be able to meet its short-term funding requirements.

Profitability to Remain Under Pressure: On an amalgamated basis, IB reported a profit of INR3.7 billion in 1QFY21 (4QFY21: net loss of INR16.4 billion). The management has guided for credit costs of 1.5%-1.8% in FY21, after factoring in the impact of COVID-19. In the agency's opinion, it could be difficult to achieve this target, given the challenging macro-economic environment. The agency expects the provisioning requirement in FY21 to remain significant due to the following: 1) ageing provisioning requirements; 2) provisioning requirements for fresh slippages; 3) provisioning for any non-banking financial company exposures if the credit migration is faster than expected; and 4) provisioning requirement for accounts declared as fraud.

RATING SENSITIVITIES

Positive: A significant increase in the market share in advances and deposits in line with higher rated banks, leading to a material increase in its systemic importance, and consistent improvement in the bank's capital and profitability buffers could lead to Outlook being revised to Positive.

Negative: A sharper-than-expected deterioration in the asset quality, weak equity buffers (close to minimum regulatory requirements) or a sizeable loss could lead to a negative rating action.

COMPANY PROFILE

IB is the seventh-largest PSB in terms of its market share in deposits and advances, with a high presence in the southern and eastern part of the country. Post the amalgamation with ALBK, the bank has a network of 6,062 domestic and three overseas branches, 4,816 ATMs and bunch note acceptors and 9,109 business correspondents.

FINANCIAL SUMMARY

Particulars	**1QFY21**	**As on 1 April 2020**
Total assets (INR billion)	5,757.7	5,680.5

Total equity (INR billion)	360.5	347.5
Net profit (INR billion)	3.7	-16.4
Return on assets (%)	0.25	-1.17
Common equity tier 1 (%)	10.30	10.23
Capital adequacy ratio (%)	13.45	13.26
Source: IB, Ind-Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Rating Watch/Outlook		
	Rating Type	Rated Limits (INR billion)	Rating	22 May 2020	25 February 2020	27 February 2019
Issuer rating	Long-term/Short-term	-	IND AA+/Stable/IND A1+	IND AA+/RWE/IND A1+	IND AA+/RWE/IND A1+	IND AA+/Stable/IND A1+
Basel III Tier 2 bonds	Long-term	INR25	IND AA+/Stable	-	-	-
Certificate of deposits	Short-term	INR120	IND A1+	IND A1+	IND A1+	IND A1+

ANNEXURE

Issue name/ Type	ISIN	Date of Allotment	Tenor (years)	Maturity Date	Amount mobilised (billion)	Coupon Rate (%)	Put/Call option	Rating/Rating Watch
Basel III Tier 2 bonds	INE428A08051	25 January 2017	10	25 January 2027	INR10	8.15	Nil	IND AA+/Stable
Basel III Tier 2 bonds	INE428A08101	27 December 2019	10	27 December 2029	INR15	9.53	Put Option - Nil, Call Option - On every anniversary date after expiry of five years from the deemed date of allotment	IND AA+/ Stable

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity levels of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators

SOLICITATION DISCLOSURES

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Applicable Criteria

Financial Institutions Rating Criteria
Rating Bank Subordinated and Hybrid Securities

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