Andhra Bank

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Certificate of Deposit Programme	35,000 (enhanced from Rs 25,000 crore)	CARE A1+ (A One Plus)	Reaffirmed
Total	**35,000**		

Rating Rationale

The rating continues to factor in the capital support and majority ownership of the Government of India (GoI) in Andhra Bank, healthy growth in deposits and advances, and comfortable capitalization levels. However, the rating also factors in the deterioration in asset quality as indicated by sharp increase in non-performing assets (NPA), and restructured assets, necessitating higher provisioning and resultant strain on profitability. Continued ownership and support by the GoI, ability of the bank to improve asset quality, maintain spreads, sustain growth in business, increase share of current and savings account (CASA) deposits and fee income, are the key rating sensitivities.

Background

Andhra Bank is a Hyderabad-based, medium-sized public sector bank which was founded in 1923. The GoI is the majority shareholder with a stake of 60.14% in the bank as on March 31, 2014. As on March 31, 2014, the bank had a wide network of 2,114 branches, 10 extension counters, 35 satellite offices and 1,847 ATMs. The bank also has two representative offices at New Jersey and Dubai. The Bank has sponsored two Regional Rural Banks (RRBs) viz Chaitanya Godavari Grameena Bank and Rishikulya Gramya Bank. The bank has an insurance joint venture with Bank of Baroda and Legal and General Plc of UK called 'IndiaFirst Life Insurance Co. Ltd.', in which the Bank has a stake of 30%. The bank along with Bank of Baroda and Indian Overseas Bank had entered into a tie-up for setting up a banking subsidiary in Malaysia, wherein the bank has a 25% stake.

Credit Risk Assessment

Majority ownership by the GoI and comfortable capital adequacy

Government of India is the major share holder and has 60.14% stake in the bank. Total Capital Adequacy Ratio (CAR) stood at 11.18% as on March 31, 2014 (as per Basel II), declining from 11.76% as on March 31, 2013. During FY14 (refers to the period April 1 to March 31), the bank allotted 30,034,539 equity shares of Rs.10 each at a premium of Rs.56.59 to the Government of India by way of preferential allotment of equity shares in respect of capital funds received to the tune of Rs.200 crore. Tier I CAR stood at 8.25% as on March 31, 2014 as against 8.52% as on March 31, 2013. Notwithstanding deterioration in capital adequacy in FY14, CAR is still at a comfortable level.

Growth in income albeit deterioration in profitability and spreads

In FY14, the Bank registered a moderate growth of 9.4% and 14.6% in advances (net) and deposits, respectively. The growth in advances increased moderately due to subdued growth of 6% in the corporate and mid corporate advances during FY14, which accounted for nearly 49% of the total advances in FY14. However, the other segments i.e. agriculture, retail credit and MSME witnessed a healthy growth of 23.2%, 15.3% and 8.6% respectively YoY during FY14. Total income in FY14 grew by 12.0% to Rs.15,630.2 crore backed by a 10.7% growth in interest income and 27.2% growth in other income. However, net interest income dropped by 0.5% in FY14 as interest expenses increased by 15.4% during the same period in comparison to a moderate growth of 10.7% rise in interest income. The muted growth in interest income was on account of rise in accounts restructured, reversal of interest income, rise in the level of NPAs and moderation in credit growth primarily to the large corporate segment. The proportion of CASA deposits of the bank dropped from 25.7% as on March 31, 2013 to 24.8% as on March 31, 2014. Also, provisioning for NPAs increased by 140.1% to Rs 1,477.2 crore in FY14. Resultantly, the net profit during FY14 reduced by 66.2% and ROTA reduced from 0.95% in FY13 to 0.28% in FY14.

Deterioration in asset quality

The bank's asset quality has seen significant deterioration in FY14 with Gross NPA (%) and Net NPA (%) increasing from 3.71% and 2.45% as on March 31, 2013 to 5.29% and 3.11% as on March 31, 2014. The NPAs in FY14 increased majorly due to slippages in the large and mid corporate segment, where NPAs increased from Rs.2,565 crore to Rs.4,461 crore. Large and mid-corporate segment contributed to 76% of the total NPAs as on March 31, 2014. The key industries contributing to the NPAs were

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and other CARE publications*

infrastructure, pharmaceuticals, engineering, food processing and iron and steel among others. Fresh NPA addition during the period FY14 was Rs.2,832 crore as compared to Rs.2,741 crore during FY13. Net NPA to net-worth deteriorated to 38.94% as on March 31, 2014 as compared to 29.47% as on March 31, 2013. Reported provision coverage ratio stood at 52.55% as on March 31, 2014 (49.57% as on March 31, 2013). Restructured assets as on March 31, 2014 amounted to Rs.10,784 crore (Rs.9,692.5 crore as on March 31, 2013) i e 10.02% of advances (FY13: 9.85%) and 125.65% of net-worth (FY13: 118.6%). Going forward, the ability of the bank to contain slippages, improve recovery of NPAs and performance of its restructured assets would be important in improving the asset quality parameters

Investment profile

The Bank's investment in SLR securities amounted to Rs.39,274.78 crore, which forms 86.6% of the aggregate investments as on March 31, 2014. SLR investment as a percentage of Net Demand and Time Liabilities (NDTL) stood at 25.21% as on March 31, 2014 as against regulatory requirement of 23%. Proportion of HTM, AFS and HFT investments as a percentage of net investments stood at 75.8%, 24.1% and 0.2% respectively at the end of March 31, 2014. The modified duration of the overall portfolio stands at 4.94 years. The income from treasury operations increased by 65% in FY14 to Rs.491.0 crore due to rise in profit on sale of investments.

Asset liability management

In one year time frame, the bank has negative cumulative mismatches in buckets above 29 days. However, the excess SLR maintained of 25.21% (regulatory requirement of 23% of NDTL) by the bank and the bank's roll over rate of deposits add strength to the liquidity profile.

Outlook

The GDP growth in FY14 stood at 4.7% which was in line with CARE's estimates. Though the growth was higher than growth for FY13 (4.5%), it was lower than the earlier official estimate of 4.9%. The subdued growth was mainly on account of low growth in the manufacturing sector which saw negative growth at -0.7% during the year while the construction and services sector saw low growth. As against this, sectors like agriculture, forestry and fishery coupled with financial services and electricity, gas and water supply saw good growth helping economic growth during the year. During the year the credit growth stood at around 14% supported by services, agriculture and personal loans.

The overall slowdown in economy and negative growth in manufacturing increased the stress on the asset quality of the banks leading to higher provisioning costs. Higher provisioning coupled with moderation in income impacted the profitability of the banks during FY14. Though the profitability of the banks was impacted, currently the Indian banks remained adequately capitalised with median Capital Adequacy Ratio (CAR) of around 11.5% (under Basel III). However, in the next 4-5 years with implementation of Basel III guidelines, the banks would be required to raise substantial equity capital.

During FY15, the Reserve Bank of India (RBI) is likely to keep its focus on inflation in view of the uncertain monsoon, due to which the interest rates are likely to remain more or less stable during the year. CARE's GDP growth forecast for FY15 is between 5.2% to 5.5% considering the new government's plan to focus more on investment in infrastructure, time bound action and improved co-ordination between the Central and State Governments to ensure smooth implementation of new Government policies. However, the recovery is expected to remain gradual in nature. Improvement in the overall economic growth and governmental clearances in projects would help recovery of the sectors like infrastructure and manufacturing. This would propel credit growth and also reduce the stress on the asset quality of banks which in turn is expected to improve profitability of the banks.

Andhra Bank has shown a healthy growth in business in FY14. However, there has been deterioration in the asset quality and profitability in FY14. Continued ownership and support by the GoI, the bank's ability to sustain growth in business, improve assets quality, profitability, diversify geographic presence, increase its share of CASA and fee income are the key rating sensitivities.

Financial Performance

(Rs. Cr)

For the period ended / as at March 31,	2012 (12m, A)	2013 (12m, A)	2014 (12m, A)
Working Results			
Interest Income	11,338.73	12,909.69	14,297.32
Interest Expenses	7,579.41	9,152.67	10,559.98
Non Interest Income	859.93	1,047.42	1,332.84
Total Income	12,198.66	13,957.11	15,630.16
Operating Expenses (Incl. Depreciation)	1,804.25	2037.21	2309.94
Provisions (excl tax)	990.73	996.16	2026.51
PAT	1,344.67	1,289.13	435.58
Deposits	105,851.22	123,795.58	141,845.12
Tangible Networth	7071.07	8,175.91	8,582.92
Advances (Net)	83,222.98	98,373.30	107,644.20
Investments	29,628.90	37,632.40	45,356.62
Total Assets	124,545.39	146,298.94	167,340.93
Key Ratios (%)			
Interest Income/Avg Interest Earning Assets*	10.59	10.26	9.83
Interest Expenses / Avg Interest Bearing Liabilities*	7.09	7.35	7.28
Interest Spread	3.50	2.91	2.55
Net Interest Margin (NIM)*	3.22	2.77	2.38
Operational Expenses / Avg Total Assets*	1.54	1.50	1.47
Operational Expenses / Total Income	14.79	14.60	14.78
Cost of Deposits*	7.02	7.45	7.42
Yield on Advances*	11.99	11.37	10.79
Core Spread (Yield on Advances - Cost of Deposits)	4.98	3.93	3.37
ROTA*	1.15	0.95	0.28
RONW*	19.89	16.91	5.20
Reported Provision Coverage Ratio for NPA	71.13	49.57	52.55
Capital Adequacy Ratio	13.18	11.76	11.18
Tier I Capital Adequacy Ratio	9.03	8.52	8.25
Credit/Deposit ratio (times)	78.62	79.46	75.89
Net NPA to Net Advances	0.91	2.45	3.11
Net NPA to Tangible Networth	10.69	29.47	38.94
Gross NPA to Gross Advances	2.12	3.71	5.29

** Note: Ratios have been computed based on average of annual opening and closing balances*
NIM has been calculated as net interest income/ average annual total assets

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