
Rating Rationale for Andhra Bank's Lower Tier II Bonds Issue Rating

Brickwork Ratings assigns “BWR AAA” for Andhra Bank's Lower Tier II Bonds Issue of INR 500 Crore or INR 5 billion.

Issue Rating: BWR AAA

Outlook: Stable

Brickwork Ratings has assigned BWR AAA (Pronounced BWR Triple A) for Andhra Bank's proposed Lower Tier II Bonds Issue of INR 500 crore or INR 5 billion. BWR AAA signifies 'Excellent Safety' and the Rating Outlook further signifies the direction of the rating being stable in the near term. Brickwork has relied upon the audited financial statements and information and clarifications provided by the issuer.

The rating factored inter alia, the majority stake held by the Govt of India, essential characteristics of the Lower Tier II bonds, comfortable capital adequacy and Tier I capital, lower term loan component in its loan assets, well diversified credit profile, stable earning assets, and higher loan loss coverage.

The bank has been consistently improving its total business over the years. During FY09, the bank has adopted several business development initiatives to grow its business and one important initiative is to bring all the branches under core banking solution (CBS). With 100% CBS branches, the bank competently managed the challenging economic conditions during FY09, to grow its total business by 23.60% to reach Rs 103,818 crore in FY09 as compared to Rs 83,993 crore during FY08.

During the year, the bank has gradually grown its asset base aided by robust growth in deposits and advances. With the help of several new deposits schemes and marketing channels, the bank's total deposits increased to Rs 59,390 crore during FY 09, from Rs 49,437 crore in FY08, reflecting a good growth rate of 20.13%. In line with mid-sized public sector banks in India, Andhra Bank is also predominately funded through term deposits. The term deposits of Andhra bank has accounted for 68.59% of the total deposit. Low cost deposits increased to Rs 18,653 crore in FY 09 as compared to Rs 16,593 crore in FY 08, representing 31.41% of the total deposits. However, in percentage term, the bank's low cost deposits to total deposits had come down by 2.16%.

Table I: Andhra Bank Financial Performance

Criteria (Rs Crore)	FY 09	FY 08	FY 07
Total Assets	68,469	56,592	47,541
Deposits	59,390	49,437	41,454
Advances	44,139	34,238	27,889
Investments	16,911	14,898	14,300
Income			
Interest Income	5,375	4,210	3,315
Non-Interest Income	765	626	447
Net Interest Income	1,627	1,340	1,412
Profit			
Operating Profit	1,288	1,057	931
Net Profit	653	576	537
Non-Performing Assets			
Gross NPAs	0.83%	1.07%	1.41%
Net NPAs	0.18%	0.15%	0.17%
CRAR	13.22%	11.61%	11.33%
Tier I	8.67%	8.54%	9.98%
ROA	1.05%	1.11%	1.22%
ROE	18.94%	17.97%	17.78%

The bank's gross advances has posted excellent growth by 28.56% to reach a level of Rs 44,428 crore in FY09 from Rs 34, 557 crore in FY08. The bank has a well diversified loan profile of agriculture credit, SME (Small, and Micro Enterprises) credit and large corporate credit. Non-food credit grew by 29.24% during FY09 to reach Rs 43,521 crore as compared to Rs 33,675 crore in FY08. During FY09, the bank's priority sector credit increased to Rs 14,955 crore in FY09 as against 13, 297 crore in FY08.

The bank posted impressive top line and bottom line figures. Andhra Bank is one of the most profitable mid-sized public sector banks in India in spite of economic down turn witnessed in the domestic market during financial year 2009. The bank's total income increased by 26.96% to Rs 4,836 crore during FY09, reflecting the significant buoyancy in core banking operations, excellent fee based income and focus on healthy earning

assets which contributed to improvement in the profitability. As a result, the bank's operating profit and net profit surged 21.86% and 13.46% respectively. Interest income recorded a growth of 27.68% to Rs 5,374 crore in FY09 from Rs 4,209 crore in FY08 as against the interest expenses which grew from Rs 2,869 crore during FY08 to Rs 3,747 crore during FY09.

Table II: Andhra Bank Financials

Financials (Rs Crore)	2008-09	2007-08
Interest Income	5,375	4,210
Interest Expenses	3,748	2,870
Net Interest Income	1,627	1,340
Other Income	765	626
Operating Income	2,392	1,966
Employees Expenses	624	509
Other Operating Expenses	133	118
Operating Profits	1,288	1,057
Provisions & Contingencies	635	481
Profit After Tax	653	575

The bank has increased income through alternate revenue streams to boost its non-interest income. Consequently, the bank's non-interest income has recorded an impressive growth rate of 22.17% to reach Rs 765 crore and it covered 66.31% of operating expense during FY09.

The bank has an internal capital adequacy assessment policy to comprehensively evaluate capital adequacy requirements. The bank's tier-I capital ratio stood at 8.67% as on 31st March 2009, which is marginally higher than the previous year figure of 8.54% under Basel II. Overall, the bank has reported capital adequacy ratio of 13.22% under Basel II as on 31st March 2009 (11.61% in FY08) while Basel I CRAR was at 12.37%.

During FY 09, the bank's Return on Assets (ROA) had decreased marginally to reach 1.09% as compared to 1.16% in FY08. However, the bank's Return on Equity (ROE) increased to 18.94% as on 31st March 2009 as against 17.97%.

The Bank has continued to show good performance in Q2 FY 10. Total deposits increased to Rs.62,279 crore, while advances increased to Rs.48,182 crore.

Table III: Andhra Bank Q2 FY 10 Key Performance

Criteria	FY 09	Q1 FY 10	Q2 FY 10
CRAR	13.22%	14.75%	14.03%
PAT (Rs Crore)	653	250	274
Gross NPAs	0.83%	0.80%	0.83%
Net NPAs	0.18%	0.22%	0.16%
Loan Loss Coverage	81.49%	85.92%	83.66%
NIM	3.03%	2.85%	3.14%
ROA	1.09%	1.48%	1.53%
Cost to Income Ratio	46.15%	49.00%	39.45%

BWR has made a study of the performance of Andhra Bank vis-à-vis its peers in certain key parameters as given in the table above. BWR rating methodology has defined peer banks as those with closely similar size/operation as the Andhra Bank.

Table IV: Andhra Bank Vs Peer Group

Key Ratios (FY 09)	AB	Peers
Capital Adequacy (Basel II)		
CRAR	13.22%	12.86%
Tier I	8.67%	8.35%
Leverage	18.31%	21.05%
Asset Quality		
Gross NPA	0.83%	1.48%
Net NPA	0.18%	0.49%
Earnings		
NIM	3.03%	2.64%
ROE	18.94%	18.54%
ROA	1.09%	1.00%
Cost to Income Ratio	46.15%	44.02%
Loan Loss Coverage	81.49%	56.01%

Key Ratios (FY 09)	AB	Peers
Liquidity		
CASA	31.41%	30.61%
Credit Deposit Ratio	75.04%	67.62%
Operating Ratios		
Cost of Funds	5.94%	6.30%
Return on funds	8.71%	8.68%

The bank's capital adequacy ratio under Basel II is 36 bps higher than its peers. As of 31st March 2009, the bank's CRAR was at 13.22% as against the peers' average of 12.86%. Similarly, the bank's Tier I capital stood at 8.67%, as against peers' average of 8.35%. The bank's Tier II capital is expected to improve with the proposed Lower Tier II bonds issue of Rs 500 crore.

As a special feature of its rating process, Brickwork calculates the leverage, which assesses the bank's net worth with reference to on and off balance sheet items. During FY 09, the bank's leverage though higher was still comfortable at 18.31 in FY 09 as compared to 16.4 in FY 08. When compared with its peers' average, the bank's leverage was lower by 274 bps.

It is observed that the bank has got the lowest cost of funds among its peers as on 31st March 2009. The bank's return on funds is comparatively higher than its peers, which has raised the Net Interest Margin (NIM) slightly from 2.86% in FY08 to 3.03% in FY09. However, the bank's NIM is 39 bps higher than its peers' average.

During FY09, the bank's return on assets and return on equity stood at 1.09% and 18.94% respectively is the highest amongst similar sized banks. Similarly, the bank's loan loss coverage ratio is best among its peers.

CASA deposit ratio at about 31.41% is 80 bps higher than its peers' average of 30.61%, though this ratio slipped from 33.60% as on 31st March 2008.

Shortcomings:

In the analysis of the Andhra Bank's performance for FY 09, a few shortcomings as under have been noticed.

- a) The share of CASA deposits has slipped from 33.60% as of 31st March 2008 to about 31.41% by 31st March 2009.
- b) The bank has restructured nearly 58,612 accounts, which is 3.5% of its gross advances during FY09. This ratio is comparatively high. Consequently, the bank's asset quality could deteriorate slightly in the coming year.
- c) The bank's operations are largely concentrated in the state of Andhra Pradesh might be a limiting factor for growth.

Industry Snapshot:

Over the years, the Indian banking sector has benefited from a stable macro economic environment with unparalleled systemic support from the Indian government. The financial year 2009 witnessed a steady deterioration in the global financial condition, which tightened the liquidity position and affected the credit off-take. Nevertheless, the Indian banking sector has skillfully tided over the crisis with ample support and measures to stimulate the economy from the government and RBI.

As scheduled, the banks have successfully implemented the Basel II norms during financial year 2009 in spite of financial crisis in the domestic market. The public sector banks especially have shown a positive growth on account of proactive measures taken by the government during the year.

While economic activity seems to be picking up, the Indian banking industry is gearing for a notable operational growth. Nonetheless, continuous monitoring and timely corrective action would be necessary as the crisis have not been fully blown over and weakness felt earlier could have repercussion on growth, margins etc. for some more time to come. While leveraging the banking technology, the banks also resorted to cross-selling and up-selling of various products and services to increase their revenues.

Bank Profile

The bank was incorporated in 1923. It was nationalized in 1980. The Govt. of India holds 51.55% stake in the Bank. The bank offers retail banking, small and medium enterprise (SME) banking, treasury and financial institutional services.

Shareholders	Stake
Government of India	51.55%
Foreign	14.73%
Retail	14.28%
Financial Institutions	19.44%

During FY 09, the bank opened 66 branches, and 70 ATMs. The bank's delivery network consists of 1432 branches and 726 ATMs as of 31st March 2009.

Rating Outlook:

Brickwork Ratings (BWR) issue rating is based on CAMEL-TP framework. The rating assigned is specific to the proposed lower Tier II bonds issue of Rs 500 crore and has taken into consideration the essential features of Lower Tier II Bonds. The rating also factored Andhra Bank's ownership structure, (majority stake held by Government of India), performance, capital adequacy as well as asset quality and has assigned a stable rating outlook for the issue.

Copyright ©, 2009, Brickwork Ratings.

Brickwork Ratings has assigned the rating based on the information obtained from issuer and other reliable sources, which are deemed to be accurate. Brickwork has taken considerable steps to avoid any data distortion; however, it does not examine the precision or completeness of the information obtained. And hence, the information in this report is presented "as is" without any express or implied warranty of any kind. Brickwork does not make any representation in respect to the truth or accuracy of any such information. The rating assigned by Brickwork should be treated as an opinion rather than a recommendation to buy, sell or hold the rated instrument. Brickwork has the right to change, suspend or withdraw the ratings at any time for any reasons. Further, Brickwork should not be held responsible for any losses incurred from publishing or reproducing this report.

Analysts

Dr. A Suresh Kumar, Lead Analyst

suresh.kumar@brickworkratings.com

Phone: 1-860-425-2742

Narahari Prashanthi, Co-Analyst

prashanthi.n@brickworkratings.com

Phone: 1-860-425-2742

Media

Anitha G

media@brickworkratings.com

Phone: 1-860-425-2742

Relationship

K N Suvarna

Sr. Vice President, Business Development

kn.suvarna@brickworkratings.com

Phone: 1-860-425-2742

Brickwork Ratings (BWR) has adopted SEBI's standardized Rating Symbols and their definition advised vide SEBI circular CIR/MIRSD/4/2011 dated June 15, 2011, with effect from June 21, 2011. While there is no change in the Rating symbol as a consequence to the above, for the amended definition of the Rating, please refer to <http://www.brickworkratings.com/scale.html>. It is clarified that the said change in the definition should not be construed as a change in the Rating.