

## Press Release for Andhra Bank's Issue Rating

**Brickwork Ratings assigns "AA+" for Proposed Tier I Perpetual Bonds of Andhra Bank.**

**Andhra Bank**

**Issue Rating: BWR AA+**

Brickwork Ratings (BWR) has assigned BWR AA+ (Pronounced BWR Double A plus) to Andhra Bank's proposed Tier I perpetual bonds issue INR 2 billion or Rs 200 crore. The rating reflects several factors including, majority ownership of the Government of India, favorable operating spread and returns, lower NPA, less risky loan portfolio, higher Tier 1 capital and leverage. However, the bank's operation largely concentrated in the state of Andhra Pradesh might be a limiting factor.

Andhra Bank, a mid sized public sector bank incorporated in 1923, was nationalized in 1980. The bank offers retail banking, small and medium enterprise (SME) banking, treasury and financial institutional services. The Government of India (GoI) is a major shareholder of Andhra Bank with a stake of 51.55%. The bank's total business increased 20.5% to reach INR 839.93 billion as on 31st March 2008. This high growth was sustained in spite of 23.55% growth recorded in the previous year - FY 2007. The bank's total deposits stood at Rs 494.36 billion, as on March 2008, a growth of 19.3% over 2007. The bank has shown adequate growth in branch expansion as well as technology platform that can help grow its business.

Andhra bank is one of the profitable mid-sized public sector banks in India, with total income of INR 48.71 billion for FY 2008, reflecting the continued buoyancy in the bank's core business income, fee based income and focus on healthy asset-quality contributed to the improvement in the profitability. Further, the bank's interest income is 71 basis points more than its peers. The non interest income of the bank has been marginally lower than that of peers. To augment non-interest income, the bank continues to pursue multi channel approach to sell insurance and investment products. The efficient cash-management system coupled with higher income helped the bank improve its cost to income ratio to 47.2% from the previous of level of 50.1%.

The bank's lower cost CASA deposits declined to 33.6% and its credit deposit ratio has been higher than its peers. These imply that the bank may have to take liquidity enhancing measures. The bank's cost of mobilizing deposits increased from 5.32% to 6.58% during the year 2008. While the bank's net interest margin at 2.86%, is satisfactory compared to peers, yet the margin for Andhra Bank declined from the level of 3.20%. The bank's return on assets also marginally dropped to 1.16% from 1.31% in the previous year. These declines in return on assets and net interest margin are largely attributed to increased cost of funds. The bank's operating expenditures have increased 33% and largely in line with total income that increased 29.5%.

While bank's cost of funds at 6.12% is slightly higher than that of peers, the bank has shown higher returns at 9.25% and higher spreads 3.14%. Even though the bank has shown higher returns, the bank's loan portfolio does not appear riskier. Gross NPAs dipped to 1.07% compared to 1.88% of peers. Net NPAs were down to 0.15% from 0.17%. The real estate loans sensitive exposure has been just 7.94%, less than half of that of bank's peers. The bank's term loan exposure at 41.95% is lower than the peers' average. The bank has large provisions of 85.39% for its non-performing assets, which compares favorably with its peers. As on 31st March 2008, the bank has recovered an amount of INR 903 million under SARFAESI Act.

While Andhra Bank's total capital adequacy ratio increased to 11.61% in FY 2008, yet the ratio is less than that of its peers. The bank needs to supplement its capital. *Brickwork* calculates *Leverage* that assesses bank's capital adequacy with reference to both on balance and off balance sheet exposures. Andhra Bank has shown a reasonable leverage of 16.4 compared to its peer group at 21.3. In spite of lower leverage the bank's ROE was healthy at 17.97% in FY 2008.

Further, the bank's total investment to total assets ratio stood at 26.33% as on 31st March 2008, on par with the peer group average. The bank's interest income from investments increased by 16.9% from INR 8.96 billion during 2006-07 to INR 10.48 billion in 2007-08 and during the period, the profit on sale of investments registered an increase of 121.9% with rupee profit of INR 1.19 billion. This is largely attributed to favorable market conditions and prudent portfolio management. In addition, the bank's yield on investments increased to 8.27% during 2007-08 from 7.34% in 2006-07.

Overall, Brickwork Ratings factored the Government of India ownership, quality of risk weighted assets, low cost deposit base, growth in income, decline in gross NPA, and lower leverage. The Bank is well placed to manage the key challenges in liquidity, credit quality declines in the coming months. The bank's concentration in a single state as well as lower CASA deposits are limiting factors in the long run.

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