Indian Overseas Bank

June 14, 2018

Summary of Rated Instrument:

Instrument	Rated Amount (Rs. crore)	Rating Outstanding
Lower Tier-II Bonds	1,590.00	[ICRA]A+ (Negative)
Upper Tier-II Bonds	2,132.30	[ICRA]A- (Negative)
Perpetual Bonds	300.00	[ICRA]A- (Negative)
Tier-II Bonds-Basel III	800.00	[ICRA]A+ (hyb) (Negative)
Certificate of Deposit	15,000.00	[ICRA]A1+
Total	**19,822.30**	

Material Event

Indian Overseas Bank (IOB) announced its Q4 FY2018 results on May 29, 2018.

Advances: IOB's gross advances declined 3.7% YoY in FY2018 to Rs. 150,999 crore due to the decline in the bank's exposure to the corporate sector by 20.3%. Consequently, the bank's share of corporate exposure contracted to 31% in March 2018 (vs 38% in March 2017). IOB's retail, agriculture & MSME (RAM) segment grew by about 9.3% and its share in gross advances improved to 61% in March 2018 (from 53% in March 2017). The bank's overseas exposure moderated to 8% (9% in March 2017). ICRA expects the bank's loan book to remain largely stable in FY2019 considering its stretched capital position.

NIMs & NII: The average yield on advances declined to 8.8% during FY2018 (9.3% in FY2017) while the cost of funds reduced to 5.5% during FY2018 (6.1% during FY2017). Net interest margins (NIMs), as a percentage of average total assets (ATA), stood at 2.2% for FY2018 (2.0% in FY2017) supported by a reduction in the cost of funds. Consequently, net interest income (NII) improved 5.3% during FY2018 despite the decline in the loan book. Going forward, with systemic interest rates hardening and the loan book expected to remain stable, the bank's NIMs and NII are expected to be under pressure.

Asset Quality: The bank's asset quality deteriorated sharply during FY2018, with gross and net NPAs increasing to 25.3% and 15.3%, respectively, as of March 31, 2018 from 22.4% and 14.0%, respectively, as of March 31, 2017. The fresh NPA generation rate increased steeply to 13.9% in FY2018 (9.1% in FY2017). The large slippages (annualised fresh NPA generation rate of 34%) during Q4 FY2018 were partly on account of the implementation of the RBI's revised framework on stressed assets. The bank's provision coverage ratio[1] improved to 46.6% in March 2018 (43.7% in March 2017) though its solvency ratio[2] deteriorated further to 186.2% in March 2018 (170.6% in March 2017). ICRA estimates that the bank's standard restructured advances, accounting for 1.3% of gross advances (as of March 2018), are expected to exert pressure on its asset quality in the near to medium term. As the elevated NPA levels exert pressure on IOB's solvency profile, it is critical for the bank to control incremental slippages and undertake effective recoveries.

Profitability: With an elevated provisioning requirement accentuated by the RBI's revised stressed assets framework, the bank's credit cost increased to 5.0% of ATA during FY2018 (2.7% during FY2017). Consequently, the bank reported a net loss of Rs. 6,299 crore in FY2018 (-2.6% of ATA) as against a net loss of Rs. 3,417 crore in FY2017 (-1.3% of ATA). The

[1] *(Gross NPA-Net NPA)/Gross NPA*

[2] *Net NPA/net worth*

bank's profitability is expected to be under pressure in FY2019, on account of NPA ageing and for improving its provision cover. Hence, it remains crucial for the bank to improve recoveries and contain credit costs, going forward.

Capitalisation: IOB's capitalisation profile remains stretched as its CET-I, Tier-1 and CRAR (as a percentage of risk-weighted assets) ratio stood at 6.4%, 7.2% and 9.3%, respectively, as on March 31, 2018, notwithstanding a Rs. 4,694-crore equity infusion by the GoI in March 2018. Post the recall of AT-1 bonds for Rs. 1,000 crore in June 2018, the bank's capital profile would weaken further. As the earnings profile is expected to remain weak in the near term, the bank is expected to witness further weakening in its capital profile unless the GoI infuses commensurate capital into the bank. ICRA notes that the coupon payments on the upper Tier-II bonds and IPDIs are due in September 2018. The bank would have to secure capital from the GoI to improve its capital profile for servicing its coupons and for meeting the increased capital requirements under Basel III regulations. As per ICRA's estimates, assuming a stable RWA[3], the bank would require about Rs. 1,300-1,400 crore of tier-1 capital to have the minimum tier-1 capital ratio of 7% by June 2018.

Impact of the Material Event

The ratings remain unchanged at [ICRA]A+(Negative)/[ICRA]A- (Negative)/[ICRA]A1+, as ICRA expects the GOI to support the bank in terms of infusing required capital. Any sizeable deterioration in the asset quality, capitalisation or the profitability profile, going forward, would also be a key rating sensitivity.

The previous detailed rating rationale is available on the following link: Click here

[3] *Risk-weighted assets*

Key Financial Indicators (audited)

Instrument	FY2017	FY2018	Q4FY2017	Q4FY2018
Net Interest Income	5,190	5,467	1,324	1,733
Profit before tax	-3,381	-8,632	-749	-5,645
Profit after tax	-3,417	-6,299	-647	-3,607
Net advances (Rs. lakh crore)	1.4	1.3	1.4	1.3
Total assets (Rs. lakh crore) (excl. Revaluation Reserves)	2.5	2.5	2.5	2.5
%CET 1	7.6%	6.4%	7.6%	6.4%
%Tier 1	8.2%	7.2%	8.2%	7.2%
%CRAR	10.5%	9.3%	10.5%	9.3%
%Net Interest Margin	2.0%	2.2%	2.1%	2.8%
%Net Profit / ATA	-1.3%	-2.6%	-1.0%	-5.8%
%Return on Average Net Worth	-27.5%	-55.6%	-21.7%	-137.0%
% Gross NPAs	22.4%	25.3%	22.4%	25.3%
% Net NPAs	14.0%	15.3%	14.0%	15.3%
% Provision coverage excl. technical write off	43.7%	46.6%	43.7%	46.6%
% Net NPA/ Net worth	170.6%	186.2%	170.6%	186.2%

Note: Average total asset (ATA) is computed on a year-end/quarter-end basis
Amounts in Rs. crore
Source: IOB and ICRA research

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About ICRA Limited:

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