Indian Overseas Bank

August 14, 2018

Summary of Rated Instrument

Instrument	Rated Amount (Rs. crore)	Rating Outstanding
Lower Tier I 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)
Certificates of Deposit	15,000.00	[ICRA]A1+
Total	**19,822.30**	

Material Event

Indian Overseas Bank (IOB) announced its Q1 FY2019 results on July 27, 2018.

Advances: IOB's gross advances declined 1% YoY and 1.5% QoQ in Q1 FY2019 to Rs. 1,48,760 crore. The bank's share in the corporate loan book contracted to 32% of the advances in June 2018 from 37% in June 2017, which also contributed to a reduction in the risk-weighted assets (RWA) to advance ratio to 85% from 105% in June 2017. IOB's RAM (Retail, Agriculture & MSME) segment grew by about 10.6% YoY and its share in gross advances improved to 61% in June 2018 (from 55% in June 2017). The bank's overseas exposure moderated to 7% in June 2018 from 8% in June 2017. ICRA expects IOB's loan book to moderate further in FY2019 considering its stretched capital position.

NIM & Profitability: IOB's net interest margin (NIM) remained low at 2.0% in Q1 FY2019 (1.6% in Q1 FY2018). Going forward, with the systemic interest rates hardening and the loan book expected to moderate further, the bank's NIM is expected to remain under pressure. The bank's high credit provision of 4.0% (of Average Total Assets) in Q1 FY2019 resulted in the bank reporting a net loss of Rs. 919 crore in Q1 FY2019 compared to a net loss of Rs. 499 crore in Q1 FY2018 (Rs. 6,299 crore in FY2018). The bank's earnings are expected to be under pressure in FY2019, on account of the continued weakness in asset quality. Hence, it remains crucial for the bank to improve recoveries and contain incremental credit costs.

Asset Quality: The bank's asset quality remained weak as gross and net NPA stood at 25.6% and 15.1%, respectively, as of June 30, 2018 (25.3% and 15.3%, respectively, as of March 31, 2018). The bank's provision coverage ratio[1] improved marginally to 48.5% in June 2018 (vs 46.6% in March 2018). However, its solvency ratio[2] weakened to 194.8% in June 2018 (184.9% in March 2018) on account of losses. Solvency, factoring in the recent equity infusion, is expected to be about 161% as on June 2018. 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.

Capitalisation: The bank's capital adequacy fell below 9% and stood at 7.98% as on June 30, 2018, as it recalled its AT-I bonds (Rs. 1,000 crore) in June 2018 and because of the losses reported for Q1 FY2019. Tier I stood at 5.77% as on June 2018. ICRA notes that the bank has received RBI approval, dated July 30, 2018, to include share application money (Rs. 2,157 crore received in July 2018) received from the Government of India (GoI) for computing CET I. The bank's CRAR is estimated to be about 9.69%, after factoring in the capital infusion in July 2018. Thus, IOB is expected to service its coupons on its upper tier II and IPDI bonds, that are due in September 2018, in a timely manner. However, incremental provision requirement on account of ageing NPAs, unprovided MTM losses on its investment book (Rs. 439.5 crore),

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

[2] *Net NPA/net worth*

and moderate operating profitability are expected to exert pressure on the bank's capitalisation profile in Q2 FY2019 and Q3 FY2019 unless it secures additional capital from the GoI or the capital markets to meet the minimum capital requirement for servicing its future coupons. ICRA would closely monitor the bank's capital profile, which is critical for coupon payments of its hybrid instruments. The bank's next coupon payment, post the September 2018 coupon (three hybrid instruments) payments, falls due in January 2019 (one hybrid instrument).

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 the required capital. Any sizeable deterioration in the asset quality or capitalisation going forward, would be a key rating sensitivity.

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

Key financial indicators (audited)

Instrument	FY2017	FY2018	Q4FY2018	Q1FY2018	Q1FY2019
Net Interest Income	5,190	5,467	1,733	1,025	1,208
Profit before tax	-3,381	-8,632	-5,646	-831	-1,269
Profit after tax	-3,417	-6,299	-3,607	-499	-919
Net advances (Rs. lakh crore)	1.4	1.3	1.3	1.3	1.3
Total assets (Rs. lakh crore) (excl. Reval Reserves)	2.5	2.5	2.5	2.5	2.4
%CET 1	7.6%	6.4%	6.4%	7.6%	5.7%
%Tier 1	8.2%	7.2%	7.2%	8.25%	5.8%
%CRAR	10.5%	9.3%	9.3%	10.6%	8.0%
%Net Interest Margin	2.0%	2.2%	2.8%	1.6%	2.0%
%Net Profit / ATA	-1.3%	-2.6%	-5.9%	-0.8%	-1.5%
%Return on Average Net Worth	-30.7%	-55.7%	-127.6%	-17.3%	-34.8%
% Gross NPAs	22.4%	25.3%	25.3%	23.6%	25.6%
% Net NPAs	14.0%	15.3%	15.3%	14.97%	15.1%
% Provision coverage excl. technical write off	43.7%	46.6%	46.6%	43.1%	48.5%
% Net NPA/ Net worth	170.6%	184.9%	184.9%	182.4%	194.8%

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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