

Indian Overseas Bank

Instruments	Amount (Rs. Crore) ¹	Rating Action (October 2016)
Tier-II Bonds Programme – Basel III	300.00	[ICRA]A+(hyb) (negative); assigned

ICRA has assigned an [ICRA]A+(hyb) (pronounced ICRA A plus hybrid) rating with a negative outlook to the Rs. 300.00 crore Basel III compliant tier-II bond programme of Indian Overseas Bank (“IOB”)².

The letters “hyb” in parenthesis suffixed to a rating symbol stand for “hybrid”, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss-severity vis-à-vis conventional debt instruments.

The assigned rating factors in the bank’s sovereign ownership (79.6% stake held by Government of India as on September 30, 2016) and its established retail franchise, which results in a healthy and stable deposits base and a good liquidity profile (liquidity coverage ratio at 293% as on March 31, 2016). ICRA also takes note of the regular and sizable equity raising by the bank – Rs. 2,211 crore from the government and LIC in FY2016 and Rs. 1,551 crore from government and Rs. 262 crore from qualified institutional buyers in the current fiscal so far; the bank expects a further equity infusion of Rs 1,550 crore from the government in current fiscal.

The rating is however constrained by IOB’s weak asset quality, capitalization and profitability profile. On account of high slippages in the corporate segment over the recent quarters, the bank’s gross NPAs stood high at 20.5% as on June 30, 2016, which adversely impacted its solvency³ (177% as on June 30, 2016) and weakened its ability to withstand any unexpected future losses. The share of standard restructured assets and other vulnerable assets in the bank’s gross advances stood at 5.2% and 2.2% respectively as on June 30, 2016, indicating likely incremental pressure on its asset quality going forward. ICRA notes that the weak operating environment for some capital intensive sectors could make recoveries challenging for the bank over the near term resulting in the NPAs remaining at elevated levels.

Given the deterioration in its asset quality, the bank’s credit cost⁴ stood high at 2.4% during FY2016 (3.2% during Q1FY2017), resulting in net profitability of -1.0% (-2.2% during Q1FY2017). Considering the bank’s NPA ageing profile, ICRA expects its credit provisioning requirement to remain high in the medium term, resulting in a pressure on its earnings. As on June 30, 2016, the bank’s provision coverage⁵ was moderate at 37%.

The bank has a weak capitalization profile with tier-1 capital at 7.39% (CET-1 at 6.78%) as on June 30, 2016, as against the minimum regulatory tier-1 capital requirement of 8.25% (CET-1 of 6.75%) by March 2017⁶. ICRA notes that the bank would require capital infusion to meet the minimum regulatory requirement given its current weak financial and business profile. As per ICRA’s estimate, the bank’s incremental total tier-1 capital requirement till FY2019 is likely to be around Rs. 9,100-11,800 crore⁷; therefore, timely equity support from government would remain a key rating sensitivity.

The bank’s gross advances declined by 5% (y-o-y) to Rs. 1.66 lakh crore and its total deposits declined by 6% to Rs. 2.18 lakh crore as on June 30, 2016. However, the share of its CASA deposits improved from 25.4% to 30.2%.

Bank Profile

IOB is a large commercial bank with majority ownership with the Government of India (79.6% as on September 30, 2016). As on June 30, 2016, the bank had an asset base (net of revaluation reserve) of about Rs. 2.6 lakh

¹ Rs. 1 crore = Rs. 10 million = Rs. 100 lakh

² For complete rating scale and definitions, please refer to ICRA’s website (www.icra.in) or other ICRA rating publications

³ Net NPA / Net-worth

⁴ Credit provisions / Average total assets

⁵ (Gross NPA-Net NPA) /Gross NPA

⁶ Including capital conservation buffer

⁷ Assuming a buffer of 1.0% over and above the regulatory minimum requirement and an annualized growth of 6-8% in risk weighted assets and internal generation (net of dividends) of 3-4% during FY2017-FY2019

crore and network of 3,401 branches. Headquartered in Chennai, IOB has a strong presence in South India; it also has an overseas presence through its 8 foreign branches, 3 representative offices, and 2 remittance centres.

Recent Results

During FY2016, IOB reported a net loss of Rs. 2,897 crore on a total asset base of Rs. 2,74,437 crore as compared with a net loss of Rs. 454 crore and an asset base of Rs. 2,85,637 crore during FY2015. In Q1FY2017, the bank reported a net loss of Rs. 1,451 crore (profit of Rs. 15 crore in Q1FY2016).

October 2016

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