



Bharat Overseas Bank

RATING HISTORY

Instrument	Rated Amount	Maturity Date	Rating Outstanding August 2006	Previous Ratings April 2005
Certificate of Deposit	Rs. 2 billion	1 year from date of placement	A1+	A1+

ICRA has reaffirmed an A1+ (pronounced A one plus) rating to the Rs.2 billion Certificate of Deposit programme of Bharat Overseas Bank Limited (BhOB). This is the highest-credit-quality rating assigned by ICRA to short-term debt instruments. Instruments rated in this category carry the lowest credit risk in the short term. BhOB's ratings take into account the deposit cost advantage it enjoys through a substantial proportion of non-resident deposits, its adequate capitalisation and risk management systems. The rating also draws comfort from the bank's parentage i.e. majority shareholding by Indian Overseas Bank (30%) and a most likely take-over in the near future by Indian Overseas Bank. As larger banks increase their focus on small and medium enterprises (SMEs)---a segment BhOB has traditionally been strong in---its ability to maintain its deposit cost advantage as it grows, would be key to its competitiveness.

BhOB, like most private banks, relies significantly on term deposits (77% of total deposits), even as it has been working towards improving the proportion of its savings deposits (16% of total deposits). Despite the higher costs normally associated with term deposits, BhOB's overall cost of deposits is comparable to that of larger nationalised banks due to a significantly large proportion of low cost non resident deposits sourced from Bangkok. As the only Indian bank with a branch in Thailand, BhOB enjoys substantial remittances from the ethnic Indian community in Bangkok.

BhOB's net advances grew by 24% in FY2006 and stood at Rs.17.22 billion as on March 31, 2006, aided by a 28% rise in its domestic credit which has been increasing at a consistent rate over the past few years. The credit in the overseas market has also grown marginally by 9% and stood at Rs.3.31 billion on March 31, 2006. The bank has not sought to grow aggressively in Bangkok and lends mainly to the expatriate Indian community with a proven track record. As for domestic credit, in what is uncommon for a bank of its size, BhOB has been able to lend at competitive rates to some prime corporate customers by leveraging on its deposit-cost advantage. BhOB's small balance sheet being a constraint limits the ticket size of large corporate credits. The bank's credit focus continues to be on SMEs, where it has a sizeable exposure to textile, engineering, chemicals and gems & jewellery firms. In order to grow the SME credit, the BhOB has introduced various concessional measures, however the extent to which these initiatives enable the Bank to grow its SME credit and resultant impact on the asset quality of the bank remains to be seen.

Over the past two years, with renewed focus on retail lending, the bank has expanded in the segment, mainly through loans against deposits, housing and personal loans. The Bank has been consciously working on its Credit-Deposit ratio that has improved to 63% in FY2006 as against 56% in FY2004, through improved

disbursement to the SME Segment in retail credit.

The yield on average advances has improved to 8.14% during 2005-06 as compared to 7.79% during the previous year. However, BhOB's yields are lowest amongst its peer group, explainable by its greater presence in competitive urban centres, when compared with other private sector banks who have been able to command higher yields in semi-urban areas.

Though the asset quality indicators of the bank had been improving over the past three years, during the year 2005-06, the same declined primarily of account of one major slippage of Rs.0.15 billion from its Bangkok branch operations. On account of the aforesaid, the NPA generation rate of the bank has increased to 1.9% during FY 2006. Despite the increase in slippages, the bank has been able to consistently make recoveries through greater emphasis on negotiation and one-time settlement of bad loans. The gross NPA and net NPA% were 3.20% and 1.87% respectively as on March 31, 2006 (3.43% and 1.55% respectively as on March 31, 2005), which though declined in FY2006, still compares favourably amongst peer banks. In ICRA's view, BhOB's small size has facilitated a personalised approach to credit risk management thus far; however, as the bank grows in size, its credit monitoring systems may need further strengthening.

The bank's investment portfolio is fairly liquid, with over 80% invested in



government and other approved securities. With the view to increase its CD ratio, BhOB has consciously moved from maintaining excess SLR to deployment of the same towards credit expansion. The overall investment portfolio of BhOB has declined to Rs.9.60 billion as on March 31, 2006 as compared to Rs.9.86 billion as on March 31, 2005. The yield on investments have remained stable at 8.40% in FY 2006 and compares well amongst peers. As on March 31, 2006, 46% of the total investment portfolio (40%- SLR portfolio) is in the AFS category. The modified duration of investments under AFS category was 3.34 as on March 31, 2006. Consequently, BhOB is more vulnerable to adverse interest rate movements on account of relatively high duration of the fixed income investment portfolio.

Given the increasing interest rate scenario in 2005-06, the growth in the interest income of the bank has been offset by the increase in cost of funds resulting in marginal growth of 1.5% in the net interest income (NII). The NIM of the bank has declined to 3.07% during the year 2005-06 as compared to 3.48% in the previous year. Though, the fee income of the bank has grown by around 13% during the current year aided by improving commission, exchange and brokerage income, it remains low at 0.69% of average total assets. The bank is conscious of the need to increase its fee-based income but due to the impending merger with Indian Overseas Bank, the bank is

following a wait and watch approach before taking any fresh initiatives on this front.

With marginal growth in NII and fee income, the operating income of the bank grew to Rs.1.31 billion during 2005-06 (Rs.1.29 billion in 2004-05). The operating expenses of the bank have increased substantially during the current year to 2.50% of average total assets from 2.32% in 2004-05 on account of wage arrears settlements, increased branch network and related expenses. The marginal growth in income base and significantly higher operating expenses have led to the operating profits of the bank decline to Rs.439 million during 2005-06 as compared to Rs.598 million in the previous year. Though the trading profits of the bank improved to Rs.14.7 million in FY2006 as against loss of Rs.54.5 million in FY 2005, the same is not adequate to make up for the decline in operating profits. With increase in tax provisions, the net profit of the bank has significantly declined to Rs. 60 million in the current year as compared to Rs.200 million during 2004-05. Subsequently, return on average assets declined to 0.16% in FY 2006 from 0.64% in FY 2005.

The regulatory capital adequacy of BhOB though adequate declined to 11.24% as on March 31, 2006 from 14.95% as on March 31, 2005 on account of strong growth in the asset base. Further it is important to note that the CRAR of the bank is composed primarily of core Tier I

capital (8.41%). The net NPA/net worth, as an indicator of solvency, weakened to 18.77% as on March 31, 2006 as compared to 12.91% as on March 31, 2005 on account of increased slippages during FY 2006.

Company Profile

Bharat Overseas Bank Limited is a small private sector bank, promoted by Indian Overseas Bank (IOB) and six other private sector banks - Bank of Rajasthan, Vysya Bank, Federal Bank, Karur Vysya Bank, South Indian Bank, Karnataka Bank. The bank was established in 1973 to take over the business of the then Bangkok branch of Indian Overseas Bank. A Government of Thailand regulation which came into force at that time disallowed banks with foreign government ownership from operating in that country. IOB remains the largest shareholder today with a 30% stake.

Headquartered in Chennai, BhOB has a network of 101 mostly-urban branches in India, with 35 branches located in Tamil Nadu and the rest widely dispersed throughout India. Internationally, the bank has continued to operate its lone branch at Bangkok. The bank's total assets stood at Rs.37.3 billion as on March 31, 2006. During the year 2005-06, BhOB reported a net profit of Rs.56 million on a total income of Rs.2.78 billion as compared to Rs.201 million and Rs.2.38 billion respectively during 2004-05.

August 2006



KEY FINANCIALS

	31-Mar-06	31-Mar-05	31-Mar-04
Total Assets	37,304	32,144	28,168
Deposits	32,440	27,492	24,715
Advances	20,535	16,514	13,915
Equity Capital	158	158	158
Net Worth	2,045	1,984	1,722
Total Income	2,777	2,380	2,301
Net Profit	56	201	351
Interest Spreads / Avg. Assets (%)	3.07%	3.48%	3.25%
Non-interest Income / Avg. Assets (%)	0.69%	0.82%	0.67%
Operating Expenses / Avg. Assets (%)	2.50%	2.32%	2.29%
Operating Profit / Avg. Assets (%)	1.11%	1.98%	1.63%
Profit after tax / Avg. Assets (%)	0.16%	0.67%	1.33%
Gross Non Performing Assets (NPA) / Gross Advances (%)	3.20%	3.43%	4.98%
Net Non Performing Assets (NPA) / Net Advances (%)	1.87%	1.55%	2.26%
Capital / Risk Assets (%)	11.24%	14.95%	16.25%
Total Deposits / Total Liabilities (%)	87%	86%	88%
Advances / Deposits (%)	63.30%	60.07%	56.30%
Savings Deposits / Total Deposits (%)	15.58%	19.39%	17.05%
Term Deposits / Total Deposits (%)	77.02%	71.40%	74.67%

Note: Amounts in Rs. Million

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