

November 24, 2017

Indian Overseas Bank

Summary of rated instruments

Instruments*	Amount (Rs. crore) ¹	Rating Action
Lower Tier-II Bonds	1,590.00	[ICRA]A+ (Negative); Reaffirmed
Upper Tier-II Bonds	2,132.30	[ICRA]A- (Negative); Reaffirmed
Perpetual Bonds	300.00	[ICRA]A- (Negative); Reaffirmed
Tier-II Bonds - Basel III	800.00	[ICRA]A+ (hyb) (Negative); Reaffirmed
Certificates of Deposit	15,000	[ICRA]A1+; Reaffirmed

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the ratings of [ICRA]A+ (pronounced ICRA A plus) to the Rs. 1,590.00 crore lower tier-II bonds programme, [ICRA]A- (pronounced ICRA A minus) to the Rs. 2,132.30 crore upper tier-II bonds programme, [ICRA]A- (pronounced ICRA A minus) to the Rs. 300.00 crore perpetual bond programme and [ICRA]A+(hyb) (pronounced ICRA A plus hybrid) to the Rs. 800.00 crore Basel III compliant tier-II bond programme of Indian Overseas Bank (IOB)². The outlook on these long-term ratings is Negative. ICRA has also reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating to the Rs. 15,000.00 crore certificates of deposit programme of IOB.

Rationale

The ratings reaffirmation factors in the majority Government of India (GoI) ownership (82.41% stake held by the GoI as on September 30, 2017), the demonstrated sovereign support through timely capital infusion during the past two fiscals, and the GoI's proposed recapitalisation plan for public sector banks (PSBs). ICRA also takes note of the bank's established retail franchise supporting its good deposit and liquidity profile.

The ratings also factor in the bank's weak asset quality indicators following high slippages and subdued recoveries, the consequent higher credit provisioning requirements resulting in net losses over the last nine quarters and its weak solvency³ profile. The bank's capitalisation profile is currently modest and timely equity infusion by the GoI under the recapitalisation plan is crucial from a near term rating perspective. In the medium term, the bank's ability to improve its asset quality indicators and turn profitable would be critical.

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

Key rating drivers

Credit strengths

- **Sovereign support in the form of regular capital infusion:** The GoI held 82.41% equity in the bank as on September 30, 2017. The GoI infused total capital of Rs. 4,660 crore during FY2016 and FY2017, which supported the bank's capital structure despite the net losses reported during these years. ICRA expects the GoI to provide adequate capital during the current fiscal as part of its bank recapitalisation plan. This would support the bank's capitalisation profile and also aid its business growth to an extent. ICRA notes that the bank's gross advances declined by 9.3% during FY2017 and further by 4.0% (annualised) during H1FY2018.
- **Established retail franchise, especially in South India:** Headquartered in Chennai, IOB has a long standing presence and established retail franchise in South India with a total branch network of 3,347 as on September 30, 2017. Following the government's demonetisation exercise, the share of CASA deposits in the bank's total deposits increased to 36.1% as on March 31, 2017 (35.6% as on September 30, 2017) from 28.7% as on March 31, 2016. The bank also has a good liquidity profile with liquidity coverage ratio of 181.4% as on March 31, 2017.

Credit weaknesses

- **Weak asset quality indicators:** IOB's gross NPAs increased steeply from 8.3% as on March 31, 2015 to 22.4% as on March 31, 2017 and remained elevated at 22.7% as on September 30, 2017 on account of high slippages and subdued recoveries. As on September 30, 2017, the bank's NPA provision cover⁴ was moderate at 45.4%, resulting in high net NPAs of 13.9%. IOB's share of standard restructured advances including SDR, S4A and 5/25 (excluding state electricity boards) was moderate at around 3.6% as on September 30, 2017, indicating potential incremental pressure on asset quality. Going forward, an improvement in the bank's asset quality will depend on the overall pick up in the economy and the bank's ability to control incremental slippages and undertake effective recoveries.
- **Modest capitalisation profile; timely capital infusion crucial in the near term:** The bank's capitalisation profile was modest with tier-I and CRAR at 7.8% and 10.3% respectively as on September 30, 2017 as against the minimum tier-I and CRAR requirement of 8.9% and 10.9% respectively by March 31, 2018. Thus, the bank is dependent on the expected capital infusion from GoI during H2FY2018 to meet its minimum regulatory capitalisation requirements. High NPAs and modest capital position resulted in a weak solvency of 172.9% as on September 30, 2017. ICRA also notes that continuous net losses have eroded the bank's distributable reserves as on September 30, 2017.
- **Net losses on the back of higher provisioning requirements:** The bank's net interest margin improved slightly to 2.0% during FY2017 (1.9% during FY2016) and further to 2.1% during H1FY2018 aided by a steady reduction in the overall cost of funds. However, IOB's operational expenses increased to 1.9% during FY2017 (1.8% during FY2016) and further to 2.2% during H1FY2018 on account of the declining asset base amidst high fixed costs. Also, the continuous deterioration in the bank's asset quality since FY2015 resulted in a steep increase in its credit provisioning requirements, leading to continuous net losses. The bank's credit provisioning increased to 2.7% during FY2017 (2.6% during FY2016) and further to 3.2% during H1FY2018, resulting in a net loss of -1.3% during FY2017 (-1.0% during FY2016) and -1.4% during H1FY2018. Going forward, the bank's profitability will be critically dependent on its ability to control incremental credit costs, which would be a key rating sensitivity.

4 (Gross NPA-Net NPA)/Gross NPA

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[ICRA Rating Methodology for Banks](#)

About the bank:

Indian Overseas Bank is a large commercial bank with majority ownership with the Government of India (82.41% as on September 30, 2017). As on September 30, 2017, the bank had an asset base (net of revaluation reserve) of about Rs. 2.43 lakh crore and a network of 3,347 branches. Headquartered in Chennai, IOB has a strong presence in South India; it also has an overseas presence through its 8 foreign branches, 1 representative offices, and 2 remittance centres.

Key Financial Indicators (Audited)

	FY2016	FY2017
Net Interest Income (Rs. crore)	5,383	5,190
Profit before Tax (Rs. crore)	-3,728	-3,381
Profit after Tax (Rs. crore)	-2,897	-3,417
Net advances (Rs. lakh crore)	1.61	1.40
Total assets (Rs. lakh crore) (adjusted for revaluation reserve)	2.72	2.45
% CET 1	7.1%	7.6%
% Tier 1	7.7%	8.2%
% CRAR	9.7%	10.5%
% Net interest margin / Average total assets	1.9%	2.0%
% Net profit / Average total assets	-1.0%	-1.3%
% Return on net worth	-21.9%	-29.5%
% Gross NPAs	17.4%	22.4%
% Net NPAs	11.9%	14.0%
% Provision coverage incl technical write-offs	47.4%	53.6%
Net NPA / Net worth	145.0%	170.6%

Source: IOB, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years				
		Type	Rated amount (Rs. crore)	November 2017	November 2016	June 2016	February 2016	October 2015	December 2014
1	Lower Tier-II bonds	Long term	1,590.00	[ICRA]A+ (Negative)	-	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]AA- (Stable)
2	Upper Tier-II bonds	Long term	2,132.30	[ICRA]A- (Negative)	-	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A+ (Stable)
3	Perpetual bonds	Long term	300.00	[ICRA]A- (Negative)	-	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A+ (Stable)
4	Tier-II bonds - Basel III	Long term	800.00	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	-	-	-	-
5	Certificate of Deposit	Short term	15,000.00	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
Lower Tier-II bonds	-	-	-		
INE565A09165	22-Aug-08	10.85%	22-Aug-18	300.00	[ICRA]A+(Negative)
INE565A09181	24-Aug-09	8.48%	24-Aug-19	290.00	[ICRA]A+(Negative)
INE565A09215	31-Dec-10	8.95%	31-Dec-20	1,000.00	[ICRA]A+(Negative)
Upper Tier-II bonds					
INE565A09173	17-Sep-08	11.05%	17-Sep-23	655.30	[ICRA]A- (Negative)
INE565A09199	1-Sep-09	8.80%	1-Sep-24	510.00	[ICRA]A- (Negative)
INE565A09223	10-Jan-11	9.00%	10-Jan-26	967.00	[ICRA]A- (Negative)
Perpetual bonds					
INE565A09207	29-Sep-09	9.30%	29-Sep-16	300.00	[ICRA]A- (Negative)
Tier-II bonds - Basel III					
INE565A09256	3-Nov-16	9.24%	3-Nov-26	800.00	[ICRA]A+ (hyb) (Negative)
Certificate of Deposit	-	-	-	15,000.00	[ICRA]A1+

Source: IOB

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About ICRA Limited:

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