

Indian Overseas Bank

October 24, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore) ¹	Rating Action
Basel III Compliant Tier-II Bonds	-	300.00	[ICRA]A+ (hyb) (Negative); assigned
Lower Tier-II Bonds	1,590.00	1,290.00	[ICRA]A+ (Negative); outstanding
		300.00	[ICRA]A+ (Negative); withdrawn
Upper Tier-II Bonds	2,132.30	1,477.00	[ICRA]A- (Negative); outstanding
		655.30	[ICRA]A- (Negative); withdrawn
Perpetual Bonds	300.00	300.00	[ICRA]A- (Negative); outstanding
Basel III Compliant Tier-II Bonds	800.00	800.00	[ICRA]A+ (hyb) (Negative); outstanding
Certificate of Deposit	15,000.00	15,000.00	[ICRA]A1+; outstanding
Total	19,822.30	19,167.00	-

* Instrument details are provided in the Annexure-1

Rating action

ICRA has assigned a rating of [ICRA]A+(hyb) (pronounced ICRA A plus hybrid)² to the Rs. 300.00-crore Basel III compliant Tier-II bond programme of Indian Overseas Bank (IOB). The outlook on the rating is Negative. ICRA has withdrawn the ratings of [ICRA]A+ (pronounced A plus) on the Rs. 300-crore lower Tier-II bonds and [ICRA]A- (pronounced A minus) on the Rs. 655.30-crore upper Tier-II bonds as these instruments have been redeemed in full with no amount outstanding against these instruments.

ICRA has ratings outstanding of [ICRA]A+ on the Rs. 1,290.00-crore lower Tier-II bonds, [ICRA]A- on the Rs. 1,477.00-crore upper Tier-II bonds and the Rs. 300-crore perpetual bonds, and [ICRA]A+(hyb) on the Rs. 800-crore Basel III compliant Tier-II bonds. The outlook on the long-term ratings is Negative. ICRA also has a [ICRA]A1+ rating outstanding on the Rs. 15,000-crore certificate of deposit programme of IOB.

The letters, “hyb” in parenthesis, suffixed to a rating symbol stand for “hybrid” and indicate 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 rated Tier-II bonds are expected to absorb losses once the point of non viability (PONV) trigger is invoked.

Rationale

The ratings consider the majority Government of India (GoI) ownership (GoI held a 89.7% stake as on September 30, 2018) and the demonstrated sovereign support through capital infusion over the past few years. ICRA also takes note of the bank’s established retail franchise supporting its good deposit base and adequate liquidity profile.

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

The ratings also factor in the bank's weak asset quality indicators (gross NPA of 25.6% as on June 30, 2018) following high slippages and relatively subdued recoveries, and a consequent increase in the credit provisioning requirements resulting in net losses over the past several quarters and a weak solvency³ profile. The ratings further take note of the stretched capitalisation profile with CRAR of 7.98% as on June 30, 2018, below the regulatory requirement of 10.88% (including CCB of 1.88%). The CRAR is estimated to be about 9.69%, after factoring in the capital infusion (Rs. 2,157 crore) by the GoI in July 2018. As the earnings profile is expected to remain weak in the near term, the capital profile is likely to remain under stress unless the GoI infuses additional capital. ICRA notes that the coupon payments on the bank's upper Tier-II bonds fall due in January 2019. Hence, the bank would have to secure timely capital from the GoI to improve its capital profile for servicing its coupons, as well as to meet the increased capital requirements under Basel III regulations.

Outlook: Negative

The Negative outlook reflects the weak asset quality indicators, which are expected to exert pressure on the bank's earnings and solvency. The ratings would be downgraded if there is a further weakening in the asset quality or delays in capital support from the GoI. The outlook would be revised to Stable if there is a significant improvement in the asset quality indicators and the overall financial risk profile.

Key rating drivers

Credit strengths

Sovereign support in the form of regular capital infusion - The GoI held 89.7% equity in the bank as on September 30, 2018. It infused cumulative capital of Rs. 9,354 crore during the last three years (FY2016-2018), which supported the bank's capital profile despite the net losses reported during these years. Further, the GoI infused Rs. 2,157 crore of equity in July 2018 with additional equity infusion expected in the current financial year. ICRA expects the GoI to infuse further equity capital in Q3 FY2019, which would be crucial for maintaining a comfortable capitalisation profile and for servicing the outstanding upper Tier-II bonds.

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 3,326 as on June 30, 2018. The bank's deposits grew by a modest 1.1% (YoY) to Rs. 2.1 lakh crore and the share of CASA deposits improved to 36.9% as on June 30, 2018 from 35.9% as on June 30, 2017 (36.8% as on March 31, 2018). IOB also has a healthy liquidity profile with a liquidity coverage ratio of 409% as on June 30, 2018.

Credit challenges

Weak asset quality indicators – IOB's asset quality remains weak as gross NPAs stood high at 25.6% as on June 30, 2018 (25.3% as on March 31, 2018) compared to 22.4% as on March 31, 2017, owing to continued slippages and subdued recoveries. The bank's provision coverage⁴ ratio improved marginally to 48.5% in June 2018 (vs 46.6% in March 2018). However, the solvency ratio 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% in June 2018.

The bank's standard restructured advances constituted 0.9% of standard advances as on June 30, 2018 while its SMA-2 portfolio stood at about 1.7%, indicating potential incremental pressure on the asset quality. ICRA also notes that the bank has exposure to 24 large accounts, referred under the Insolvency and Bankruptcy Code (IBC), constituting 5.1% of

³ Net NPA / Net worth

⁴ (Gross NPA – Net NPA)/Gross NPA

advances as on June 30, 2018, against which it has provisions of about 75%. Given the significant quantum and provisions held by the bank for the cases being resolved under the IBC, effective recoveries from these accounts remain a key driver for reduction in NPA levels and improvement in the asset quality.

ICRA takes note of the increase in the stress in the MSME book with NPAs in this segment accounting for 19.0% in June 2018. MSME exposures accounted for about 50% of the SMA-2 book. Ability to control incremental slippages in this segment would also be crucial from an overall asset quality perspective.

Stretched capitalisation profile; timely capital infusion crucial in the near term – The bank’s capital adequacy ratio 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. The Tier-I capital stood at 5.77% as on June 30, 2018. The bank’s CRAR is estimated to be about 9.69%, after factoring in the capital infusion in July 2018. However, incremental provision requirement on account of ageing NPAs, unprovided mark-to-market (MTM) losses on its investment book (Rs. 439.5 crore) and moderate operating profitability are expected to exert pressure on internal generation and hence capitalisation in the near term, unless it secures timely capital from the GoI. Given that the coupon payment of the hybrid instrument falls due in January 2019, ICRA would closely monitor the bank’s capital profile, which is critical for servicing the coupon.

Weak earnings profile - IOB has reported losses since FY2015 largely because of elevated provisions. The bank’s NIM has remained stable at about 2.0% over the last two fiscals and in Q1 FY2019. The operating profitability (before provisions and net trading income) stood at 1.7% in Q1 FY2019. Going forward, with the systemic interest rates hardening and the loan book expected to moderate further, the bank’s NIM could witness pressure. ICRA, however, takes note of the various initiatives taken by the bank to optimise its operating cost and improve its fee/commission income, which would lend support to its operating profitability. The operating cost to operating income⁵ ratio improved to 52% in Q1 FY2019 compared to 66% in Q1 FY2018. IOB’s credit provision, however, was high at 4.0% (of average total assets) in Q1 FY2019 and this led to 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 (net loss of Rs. 6,299 crore in FY2018). The bank’s earnings are expected to remain under pressure in FY2019, on account of the provisioning requirement for ageing NPAs and likely MTM losses owing to the firming up of bond yields. Hence, it remains crucial for IOB to improve recoveries and contain incremental credit costs.

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

Links to applicable criteria:

[ICRA’s Credit Rating Methodology for Banks](#)

About the company

Indian Overseas Bank is a large commercial bank with the Government of India having majority ownership (89.7% as on September 30, 2018). As on June 30, 2018, the bank had an asset base (net of revaluation reserve) of about Rs. 2.4 lakh crore and a network of 3,326 branches. Headquartered in Chennai, IOB has a strong presence in South India. It also has an overseas presence through 7 foreign branches, 1 representative office, and 2 remittance centres.

For Q1 FY2019, the bank reported a net loss of Rs. 919 crore (Rs. 499 crore in Q1 FY2018) on a total asset base of Rs. 2,37,125 crore (Rs. 2,49,616 crore as on June 30, 2017). For FY2018, IOB reported a net loss of Rs. 6,299.0 crore (Rs. 3,417 crore in FY2017) on a total asset base of Rs. 2,45,865 crore as on March 31, 2018 (Rs. 2,45,002 crore as on March 31, 2017).

⁵Operating expenses/(Total income - interest expense - profit on sale of investments)

Key financial indicators

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%	1.4%	2.0%
%Net Profit / ATA	-1.3%	-2.6%	-5.8%	-0.7%	-1.5%
%Return on Average Net Worth	-27.5%	-55.6%	-138.0%	-17.6%	-35.0%
% 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-offs	43.7%	46.6%	46.6%	43.1%	48.5%
% Net NPA/ Net worth	170.6%	186.2%	186.2%	182.0%	195.7%

Note: Average total asset (ATA) is computed on a year-end/quarter-end basis

Amounts in Rs. crore

Source: IOB and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

S. No	Instrument	Type	Current Rating (FY2019)		Chronology of Rating History for the past 3 years					
			Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	October 2018	November 2017	November 2016	June 2016	February 2016	October 2015
1	Basel III compliant Tier-II bonds	Long term	300.00	300.00	[ICRA]A+ (hyb) (Negative)	-	-	-	-	-
2	Lower Tier-II bonds	Long term	1,290.00	1,290.00	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)
3	Upper Tier-II bonds	Long term	1,477.00	1,477.00	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)
4	Perpetual bonds	Long term	300.00	300.00	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)
5	Tier-II bonds - Basel III	Long term	800.00	800.00	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	-	-	-
6	Certificate of Deposit	Short term	15,000.00	15,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Lower Tier-II bonds	Long term	300.00	-	[ICRA]A+ (Negative) withdrawn	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)
8	Upper Tier-II bonds	Long term	655.30	-	[ICRA]A- (Negative) withdrawn	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)

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

ISIN	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE565A09256	Basel III Compliant Tier II Bond	3-Nov-16	9.24%	3-Nov-26	800.00	[ICRA]A+ (hyb) (Negative)
NA		Yet to be placed			300.00	[ICRA]A+ (Hyb) (Negative)
INE565A09181		24-Aug-09	8.48%	24-Aug-19	290.00	[ICRA]A+ (Negative)
INE565A09215	Lower Tier-II bonds	31-Dec-10	8.95%	31-Dec-20	1,000.00	[ICRA]A+ (Negative)
INE565A09165		22-Aug-08	10.85%	22-Aug-18	300.00	[ICRA]A+ (Negative); withdrawn
INE565A09199		1-Sep-09	8.80%	1-Sep-24	510.00	[ICRA]A- (Negative)
INE565A09223	Upper Tier-II bonds	10-Jan-11	9.00%	10-Jan-26	967.00	[ICRA]A- (Negative)
INE565A09173*		17-Sep-08	11.05%	17-Sep-23	655.30	[ICRA]A- (Negative); withdrawn
INE565A09207^	Perpetual bonds	29-Sep-09	9.30%	29-Sep-19	300.00	[ICRA]A- (Negative)
NA	Certificate of Deposit	-	-	7-365 days	15,000.00	[ICRA]A1+

Source: IOB; * Call option exercised in September 2018

^ Call option available at the end of 10 years (with prior approval from the RBI)

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