MARCH 01, 2016

CARE REVISES THE RATING ASSIGNED TO THE BASEL III COMPLIANT ADDITIONAL TIER I PERPETUAL BOND ISSUES OF INDIAN OVERSEAS BANK

Rating

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Basel III Compliant Additional Tier I Perpetual Bonds @	1,000 (Rupees One Thousand crore only)	**CARE BBB (Triple B)**	Revised from 'CARE A-' (Single A Minus)
Basel III Compliant Additional Tier I Perpetual Bonds (Proposed Public issue)@	1,000 (Rupees One Thousand crore only)	**CARE BBB (Triple B)**	Revised from 'CARE A-' (Single A Minus)

@ CARE has rated the aforesaid Basel III Compliant Tier-I Perpetual Bonds after taking into consideration its key features as below:

- The bank has full discretion at all times to cancel coupon payments.
- The coupon is to be paid out of current year profits. However, if the current year's profits are not sufficient, coupon payment may be paid subject to availability of sufficient revenue reserves and/or credit balance in profit and loss account provided the bank meets the minimum regulatory requirements for Common Equity Tier I [CET I], Tier I and Total Capital Ratios at all times and subject to the requirements of capital buffer frameworks as prescribed by the Reserve Bank of India [RBI].
- The instrument may be written-down upon CET I breaching the pre-specified trigger of 5.5% before March 31, 2019, and 6.125% on and after March 31, 2019, or written-off / converted into common equity shares on occurrence of trigger event called point of non-viability (PONV). The PONV trigger shall be determined by RBI.

Any delay in payment of interest/principal (as the case may be) due to invocation of any of the features mentioned above would constitute as an event of default as per CARE's definition of default and as such these instruments may exhibit a somewhat sharper migration of the rating compared with the conventional subordinated debt instruments.

Rating Rationale

The revision in rating assigned to the Basel III compliant Additional Tier I (AT1) Perpetual bond issues of Indian Overseas Bank (IOB) is driven by higher than anticipated losses reported by the bank during Q3FY16 (refers to the period October 01 to December 31), inter-alia due to significant increase in provisions for non-performing assets (NPA) subsequent to Asset Quality Review (AQR) of RBI. The rating also factors in likelihood of continuation of weak performance in the immediate term due to provisioning requirement.

Given the features of the AT1 perpetual bond (Basel III), going forward, ability of the bank to earn adequate profits after provisioning is critical.

As on December 31, 2015, CET1, Tier I CAR and Total CAR stood at 6.43%, 7.16% & 9.73% respectively as against regulatory minimum requirement of 6.125%, 7.625% and 9.625% respectively as on March 31, 2016. Given that present capital adequacy levels are marginally above regulatory requirement, timely mobilisation of capital is critical for the bank.

With relatively higher proportion of stressed assets[2] in total advances, improvement in the profitability in the near term amidst a subdued macro-economic environment remains challenging. The ratings continue to derive strength from the majority ownership by Government of India (GoI), long standing track record of operations and strong presence of the bank in South India.

Background

Indian Overseas Bank (IOB) established in 1937 at Chennai, is one of the larger public sector banks with a sizeable footprint in South India. As on March 31, 2015, the bank had a network of 3,381 domestic branches (1,028 rural, 947 semi-urban, 747 urban and 659 metropolitan branches), 8 overseas branches, 3 representative offices and a network of 3,571 ATMs spread across the country. As on December 2015, GoI held 81.19% stake in IOB.

Continuing deterioration in Asset Quality

Asset quality of the bank continued to witness deterioration during Q3FY16 subsequent to asset quality review by RBI. The bank reported Gross NPA ratio of 12.64% and Net NPA of 8.32% as on December 31, 2015 as against Gross NPA of 8.33% and Net NPA of 5.68% as on March 31, 2015 following the asset quality review by RBI to bring consistency in NPA recognition for stressed accounts in the banking sector. Net NPA to Networth increased to 101.4% as on December 31, 2015 as against 70.4% as on March 31, 2015.

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[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

[2] *Stressed Asset is the sum of Standard Restructured assets and Gross NPA*

Stressed assets increased from 17.31% as on March 2015 to 20.14% as on December 31, 2015 (20.89% as on September 2015). Though the bank has been taking various initiatives to contain slippages and improve asset quality, given significant exposure to Iron & Steel, Metals and infrastructure sector, improvement in the bank's asset quality would be largely dependent on the pace of economic recovery, going forward.

Significant losses incurred in 9M'FY16

During 9MFY16, total income has seen a growth of 3% on y-o-y basis. However, Net Interest Income (NII) declined by 1% to Rs.4,075 crore (PY: Rs.4,128 crore) primarily due to the interest reversal on the NPAs. Though the bank has reported operating profit of Rs.2,171 crore in 9MFY16, on account of higher NPA provision amounting to Rs.4,261 crore due to deterioration in asset quality, it has reported net loss of Rs.1,961 crore.

As on December 31, 2015, IOB's total CAR stood at 9.73% with Tier I CAR of 7.16% and CET I CAR of 6.43%. Total deposits stood at Rs. 230,670 crore with CASA of 26.3% and net advances stood at Rs. 170,358 crore as on December 31, 2015.

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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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