CARE Ratings
Professional Risk Opinion

OCTOBER 21, 2015

CARE REVISES THE RATINGS ASSIGNED TO THE DEBT INSTRUMENTS OF INDIAN OVERSEAS BANK

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Lower Tier II Bonds (Series VIII)	200 (Rupees Two Hundred crore only)	**CARE A+ (Single A Plus)**	Revised from 'CARE AA-' (Double A Minus)
Lower Tier II Bonds (Series X)	300 (Rupees Three Hundred crore only)	**CARE A+ (Single A Plus)**	Revised from 'CARE AA-' (Double A Minus)
Basel III Compliant Tier I Perpetual Bonds @	1,000 (Rupees One Thousand crore only)	**CARE A- (Single A Minus)**	Revised from 'CARE A' (Single A)

@ 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, i.e. payment of such coupon is likely to result in losses during the current year, the balance of coupon payment may be made out of 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 and 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 ratings assigned to the bond issues of Indian Overseas Bank (IOB) is primarily on account of continuing moderation in asset quality wherein both non-performing assets & restructured advances have increased and moderation in financial performance during Q1FY16 (refers to the period April 01 to June 30). The ratings continue to factor in the majority ownership by Government of India (GoI), long standing track record of operations and strong presence of the bank in South India.

The ratings also take note of proposed equity infusion of Rs.2,009 crore by GoI to strengthen the capital adequacy level which is presently slightly above regulatory requirement. As on June 2015, CET1 and total CAR stood at 6.33% & 9.75% respectively as against regulatory requirement of 6.125% and 9% respectively as on March 2016. While the proposed equity infusion is expected to improve CAR, prevention of any further losses/slippages is key to maintain CAR well above regulatory requirement. Ability of the bank to improve its asset quality by preventing any significant slippages and improve profitability will be critical for its prospects. Given the relatively higher proportion of standard restructured assets in total advances and significant exposure to metal & infrastructure, improvement in the performance amidst a challenging environment would be the key rating sensitivity.

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

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 June 2015, GoI held 73.80% stake in IOB.

Credit Risk Assessment

Continuing Moderation in Asset Quality

During Q1FY16, total income has seen a growth of 6% on y-o-y basis. However the Net Interest Income (NII) moderated by 7% to Rs.1,329 crore (PY: Rs.1,427 crore) primarily due to the decrease in the yield on advances by 36bps.

Though the bank has reported operating profit of Rs.556 crore in Q1FY16, on account of higher provisions related to employee costs (including arrears) and NPA provision due to deterioration in asset quality, IOB reported before tax loss of Rs.107 crore. However, bank has reported a PAT of Rs.15 crore (PY: Rs.272 crore) on account of tax reversal. Asset quality of the bank continued to witness deterioration in Q1FY16. The bank reported Gross NPA ratio of 9.40% and Net NPA of 6.31% as on June 30, 2015 as against Gross NPA of 8.33% and Net NPA of 5.68% as on March 31, 2015.

Standard restructured advances which increased from 6.80% of gross advances as on March 31, 2014 to 8.98% as on March 31, 2015 increased further to 9.89% as on June 30, 2015. Stressed assets$ increased from 11.18% of gross advances as on March 31, 2014 to 17.31% as on March 2015 which has further increased to 18.93% as on June 30, 2015. Stressed assets as a % of networth stood at 237.44% as on June 30, 2015 (185.78% as on March 31, 2015).

IOB's CAR (under Basel III) stood at 9.75% as on June 30, 2015 (10.11% as on March 31, 2015) and Tier 1 CAR stood at 7.06% as on June 30, 2015 marginally above the regulatory requirement of 7% stipulated by the RBI. Common Equity Tier 1 (CET1) ratio remains relatively low at 6.33% as on June 30, 2015. Equity infusion of Rs.2,009 crore by GoI is under process to strengthen the capital adequacy level which is presently slightly above regulatory requirement. While the proposed equity infusion is expected to improve CAR, prevention of any further losses/slippages is key to maintain CAR well above regulatory requirement. It is to be noted that recently RBI has initiated prompt corrective action and given directions to the bank for improving its performance.

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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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