Indian Overseas Bank

December 22, 2017

Ratings

Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Basel III Compliant Additional Tier I Perpetual Bonds @	1,000 (Rupees One thousand crore only)	**CARE BBB (Triple B) (Credit watch with negative implications)**	Placed on credit watch with negative implications

Details of instruments/facilities in Annexure-1

@ CARE has rated the aforesaid Basel III Compliant Additional Tier-I (AT1) 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*
  - i. *Profits brought forward from previous years, and/or*
  - ii. *Reserves representing appropriation of net profits, including statutory reserves, and excluding share premium, revaluation reserve, foreign currency translation reserve, investment reserve and reserves created on amalgamation.*

  The accumulated losses and deferred revenue expenditure, if any, shall be netted off from (i) and (ii) to arrive at the available balances for payment of coupon.
- However, payment of coupons on PDIs from the reserves is subject to the issuing bank meeting minimum regulatory requirements for CET1, Tier 1 and Total Capital ratios including the additional capital requirements for Domestic Systemically Important Banks at all times and subject to the restrictions under the capital buffer frameworks.
- *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 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.

Detailed Rationale & Key Rating Drivers

Indian Overseas Bank (IOB) has been reporting losses over the last three years ended March 31, 2017 primarily driven by the weakening asset quality. The losses have continued during the six months period ended September 30, 2017 and this has adversely affected the distributable reserves, a critical feature of the terms of Basel III compliant Additional Tier I (AT-I) perpetual bond issue. In view of this, the rating has been placed on credit watch with negative implications. The bank is in discussions with various stakeholders on resolving the above issue and clarity on the same is yet to emerge. CARE will closely follow the developments in this regard and will consider taking appropriate rating action in due course.

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

The rating continues to derive strength from the majority ownership by Government of India (GoI) and demonstrated strong support by GoI including periodical capital infusions in the past. GoI has infused equity of Rs.2,651 crore during FY17 (refers to the period April 01 to March 31). The rating also factors in the long standing track record of operations of the bank with strong presence in South India. Weak asset quality, moderate capital adequacy and continuing losses in FY17 & H1FY18 (refers to the period April 01 to September 30) despite reporting operating profit remain key rating constraints.

Detailed description of the key rating drivers

Key Rating Strengths

Majority ownership by Government of India (GoI) and demonstrated strong support

GoI holds majority stake of 82.41% in the bank as on September 30, 2017. GoI has demonstrated its strong support to the bank including periodical infusion of capital. GoI has infused equity of Rs.2,651 crore during FY17 as against Rs.2,009 crore in FY16. GoI, being the majority shareholder is expected to lend its support, going forward also.

Long standing track-record of operations and strong South India presence

IOB, with a network of 3,373 domestic branches and business mix of Rs.3,68,119 crore as on March 31, 2017, is one among the large public sector banks operating in the country. IOB has more than eight decades of operational track record and has a strong franchise in terms of its branch network more so in South India. More than half of deposits and advances originate in the Southern region. IOB also has a small overseas presence with a network of 8 branches.

Key Rating Weaknesses

Decline in advances during FY17; however, share of corporate advances declining for the past two years

During FY17, advances declined by 13% from Rs.1,60,861 crore as on March 31, 2016 to Rs.1,40,459 crore as on March 31, 2017. The shift in bank's focus from Corporate to Retail and SME has resulted in decline in the share of Corporate advances from 50% of gross advances as on March 31, 2015 to 37% of gross advances as on March 31, 2017. The share of retail and SME together as a % of gross advances increased from 24% as on March 31, 2015 to 35% as on March 31, 2017. IOB's deposits declined by 6% to reach Rs.2,11,343 crore as on March 31, 2017. However, the proportion of CASA increased from 29.10% as on March 31, 2016 to 36.09% as on March 31, 2017.

Continuation of losses in FY17 due to higher provisions despite improvement in operating profit

During FY17, total income decreased by 11% to Rs.23,091 crore (PY: Rs.26,046 crore). However, operating profit improved from Rs.2,885 crore in FY16 to Rs.3,650 crore in FY17 on account of increase in recovery in write-off accounts and profit on sale on investments.

However, on account of higher provisions of Rs.7,031 crore (PY: Rs.6,614 crore), the bank has made a net loss of Rs.3,417 crore in FY17 as compared to net loss of Rs.2,897 crore in FY16. During H1FY18 also, the bank has made an operating profit of Rs.1,815 crore (PY: Rs.1,755 crore). However, on account of higher provisions amounting to Rs.3,846 crore, net loss was Rs.1,722 crore.

Going forward, incremental provisions required on account of category shift within NPAs and any fresh slippages would have a direct impact on profitability though the bank is continuously able to make profit at the operating level.

Continuing deterioration in Asset Quality during FY17 **despite improvement in recovery**
The asset quality of IOB continued to witness deterioration in FY17. As on March 31, 2017, Gross NPA and Net NPA of the bank stood at 22.39% (17.40% as on March 31, 2016) and 13.99% (11.89% as on March 31, 2016) respectively. Net NPA/Networth stood at 170.56% as on March 31, 2017 (144.95% as on March 31, 2016).
Stressed Assets (Standard Restructured Advances + Security Receipts Outstanding + GNPA/NNPA) as a % of Gross Advances increased from 23.33% as on March 31, 2016 to 27.52% as on March 31, 2017. The bank has stepped-up the recovery efforts which has led to improvement in upgradations from Rs.1,814 crore in FY16 to Rs.3,325 crore in FY17 and recoveries from NPA with cash recoveries of Rs.1,676 crore in FY17 (PY: Rs.1,480 crore). Apart from the cash recovery, there were also recoveries from written-off accounts to the tune of Rs.820 crore in FY17 (PY: Rs.568 crore).
As on September 30, 2017, GNPA and NNPA stood at 22.73% and 13.86% respectively.

Moderate capitalization levels
IOB's CAR (under Basel III) stood at 10.50% as on March 31, 2017 which is marginally above the regulatory requirement of 10.25% (including capital conservation buffer) stipulated by the RBI. Tier I CAR stood at 8.21% as on March 31, 2017 with Common Equity Tier 1 (CET1) capital of 7.58%. The capital infusions from GoI in the past few years have helped the bank maintain CAR levels. With the prescribed CAR of 10.875% (CET1 of 7.375%) as on March 31, 2018, timely mobilisation of capital is key to maintain capitalisation levels. As on September 30, 2017, CAR and Tier I CAR stood at 10.32% and 7.80% respectively with CET I at 7.08%.

Industry outlook and prospects
Bank credit has remained lacklustre in FY17 with subdued growth of 4.4% in FY17 as against 8.7% growth of FY16. Credit growth witnessed by the banking sector during FY17 was one of the lowest in the past few decades. The slowdown in bank credit can be mainly ascribed to subdued credit off-take by industry, increase in gross non-performing assets of banks and corporates opting for bond market funding given the competitive interest rates in these markets. In terms of sectoral offtake, credit growth in FY17 continued to be driven by the services and retail segment.
Corporates also resorted to mobilising funds for working capital from the commercial paper market instead of banks which also played a role in decreasing the growth rate of advances of banks. Asset quality pressure continued which led to increased provisioning and dampened profitability for the banking sector. Going forward, the revival in the banking sector hinges on economic revival which would lead to growth in credit and improvement in asset quality.

Analytical approach:
Standalone

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Financial sector
Bank - CARE's Rating Methodology for Banks
Criteria for placing rating on credit watch
Bank - Rating framework for Basel III instruments (Tier I & Tier II)

About the Company
Indian Overseas Bank (IOB) was established in 1937 in Chennai and is one of the larger public sector banks with a sizeable footprint in South India. As on March 31, 2017, the bank had a network of 3,373 domestic branches (922 rural, 1,001 semi-urban, 692 urban and 758 metropolitan branches), 8 overseas branches, 2 representative offices and an ATM

network of 3,679, spread across the country. IOB is holding 35% stake in 'India International Bank (Malaysia)' through a joint venture with Bank of Baroda and Andhra Bank. IOB has also entered into Non-Life Insurance business with Universal Sompo General Insurance (USGI) Company Limited with equity participation of 19% through joint venture with Allahabad Bank, Karnataka Bank and Dabur Investments. As on September 30, 2017, GoI held 82.41% stake in IOB. Mr. R. Subramaniakumar is the MD & CEO of the bank.

During FY17 (refers to the period April 01 to March 31), IOB reported a net loss of Rs.3,417 crore on a total income of Rs.23,091 crore. During H1FY18 (refers to the period April 01 to September 30), the bank reported a loss of Rs.1,722 crore on a total income of Rs.10,785 crore.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	26,046	23,091
PAT	(2,897)	(3,417)
Total Assets	272,025	245,002
Net NPA (%)	11.89	13.99

A: Audited

Status of non-cooperation with previous CRA:
Not Applicable

Any other information:
Not Applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: *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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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Tier I Bonds	Feb 04, 2015	10.00	-	1000.00	CARE BBB (Under Credit watch with Negative Implications)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (06-Jan-15)
2.	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (06-Jan-15)
3.	Bonds-Lower Tier II	LT	-	-	-	-	1)Withdrawn (27-Jul-15)	1)CARE AA (06-Jan-15)
4.	Bonds-Lower Tier II	LT	-	-	-	1)Withdrawn (06-Oct-16)	1)CARE A+ (21-Oct-15) 2)CARE AA- (27-Jul-15)	1)CARE AA (06-Jan-15)
5.	Bonds-Lower Tier II	LT	-	-	-	1)Withdrawn (06-Oct-16) 2)CARE A+ (29-Jul-16)	1)CARE A+ (21-Oct-15) 2)CARE AA- (27-Jul-15)	1)CARE AA (06-Jan-15)
6.	Bonds-Tier I Bonds	LT	1000.00	CARE BBB (Under Credit watch with Negative Implications)	-	1)CARE BBB (29-Jul-16)	1)CARE BBB (01-Mar-16) 2)CARE A- (21-Oct-15) 3)CARE A (27-Jul-15)	1)CARE A+ (06-Jan-15)
7.	Bonds-Tier I Bonds	LT	-	-	-	1)Withdrawn (06-Oct-16) 2)CARE BBB (29-Jul-16)	1)CARE BBB (01-Mar-16) 2)CARE A- (01-Feb-16)	-

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