

Press Release

Indian Overseas Bank

February 12, 2021

Rating Assigned



Total Facilities Rated*	Rs. 500.00 Cr
Long Term Rating	ACUITE AA-/ Stable (Assigned)

*Refer annexure for details

Rating Rationale

Acuite has assigned the long term rating of '**ACUITE AA-**' (read as **ACUITE double A minus**) on the Rs. 500.00 Cr proposed Basel III Compliant Tier-II Bond program of Indian Overseas Bank (IOB). The outlook is '**Stable**'.

The rating takes into account the strong ownership and demonstrated capital support from the Government of India (GoI). GoI holds 95.84 percent stake in IOB Bank as on September 30, 2020, which is one of its largest shareholdings in any public sector bank and has infused equity capital of Rs. 22,625 Cr into the bank during FY2017-2020. The rating also factors in the IOB's well established branch network with pan India presence, high provision coverage ratio at 89.36 percent as on September 30, 2020 and a strong deposit franchise. The bank has a comfortable Current Account Saving Account (CASA) base, which accounted for 40.26 percent of the total domestic deposits as on September 30, 2020. Acuite has also taken note of IOB's focus on relatively low risk retail home and jewel loans which collectively accounted for 28 percent of gross advances as on September 30, 2020. However, these strengths are partly offset by moderate capitalization levels, legacy asset quality challenges with gross NPA levels of 13.04 percent as on September 30, 2020, and weak profitability. The bank has nevertheless, shown initial signs of turnaround over the past three quarters, i.e. since March 2020, registering profits and a decline in GNPA levels.

About IOB

Chennai based Indian Overseas Bank (IOB) was founded in 1937 and nationalised in 1969. The bank is engaged in retail banking, corporate/wholesale banking, priority sector banking, treasury operations and other banking services. The bank operates through a network of 3,221 branches across India and 4 overseas branches as on September 30, 2020. Government of India is a majority stakeholder with 95.84 percent stake in the bank as on September 30, 2020.

Analytical Approach

Acuite has considered the standalone business and financial risk profile of IOB to arrive at the rating. The ownership and the ongoing support from the Government of India is central to the rating.

Key Rating Drivers

Strengths

- **Ownership and demonstrated capital support from the Government**

Indian Overseas Bank (IOB), headquartered in Chennai, is among the 14 banks nationalised in 1969. The Government of India (GoI) holds 95.84 percent stake in IOB Bank as on March 31, 2020 (92.52 percent as on March 31, 2019), which is one of its largest shareholdings in any public sector bank. The bank has a pan-India presence through a network of 3,221 branches of which 30 percent branches are in the semi-urban region of India followed by 28 percent in rural areas, 22 percent in large urban centers and balance 20 percent in urban region. IOB has a moderate international presence with 4 overseas branches, one each in Singapore, Hong Kong, Colombo and Bangkok. The bank plays a vital role in supporting various financial inclusion initiatives of the Government.

The GoI has been proactively supporting the Public sector Banks through a regular infusion of funds in order

to ensure their financial health, necessary for discharging their role as catalysts of economic growth and financial inclusion. The GoI had recently announced mergers amongst the various public sector banks as a consolidation measure. As a part of this initiative, most of the relatively weak banks are being merged with the stronger PSU Banks based on criteria such as geographical orientation, technology platform commonality etc. Indian Overseas Bank, despite being under PCA framework, has been able to retain its independent identity as the Government has kept the bank outside the scope of these mega-mergers. This indicates the regional importance of IOB.

On account of the continued deterioration in its key operating metrics such as Capital Adequacy, Profitability and Asset Quality, Indian Overseas Bank was included in the PCA framework in 2015. Government has on an aggregate basis, infused Rs. 22,625 Cr in Indian Overseas Bank from FY2017 till FY2020, indicating the strategic importance of Indian Overseas Bank. The ongoing support from GoI has helped Indian Overseas Bank in maintaining its overall Capital Adequacy (CAR) which stood at 10.90 percent as on September 30, 2020 as against the required benchmark level 10.875 percent; CAR levels stood at 10.72 percent as on March 31, 2020 and 10.21 percent as on March 31, 2019. The tier-I equity capital stood at 8.36 percent as on September 30, 2020. While the reported CAR levels remain close to the regulatory requirements, the improvement in profitability is likely to build a moderate capital cushion over the near to medium term. Since the bank continues to remain under PCA, additional capital support from the Government can also be expected.

Acuite believes that the GoI will continue to provide significant support to large public sector banks like IOB, which plays a critical role in penetration of financial services and social development. Nonetheless, any material dilution in stake by the Government as part of the divestment programme will be a key monitorable.

- **Improving base of low cost deposits**

The resource profile of IOB derives significant strength from a robust Current Account Savings Account (CASA) base which has been steadily improving from 36.75 percent as on March 31, 2018 to 40.26 percent as on September 30, 2020 aided by steady accretion of savings deposits coupled with a considerable reduction of bulk deposits over this period. Despite a significant reduction in deposit rates including savings rates, the retail deposits grew by 14.08 percent year-on-year and CASA deposits increased by 9.27 percent year-on-year at the end of HFY2021. This growth was partly also contributed by the increased risks perceived by depositors in the smaller private sector and cooperative banks. In line with the lower interest rates, the average cost of deposit has declined from 5.49 percent as on March 31, 2018 to 4.80 percent as on September 30, 2020. Further, the increasing share of retail deposits in the overall deposit base at 50.35 percent as on March 31, 2020 reflects the strong retail franchise in its key operating regions.

Acuite expects Indian Overseas Bank to continue to benefit by way of access to lower cost of funds on the back of its sovereign parentage, stable retail deposit base and improving CASA share.

Weaknesses

- **Moderate Asset Quality**

Asset quality will remain a concern for the bank given the past legacy and the weak economic environment which got aggravated further due to the Covid pandemic. IOB's GNPA levels have nevertheless, steadily improved over the years from 25.28 percent as on March 31, 2018 to 14.78 percent as on March 31, 2020. The GNPA levels as on September 30, 2020 stood at 13.04 percent. The improvement was primarily on account of aggressive write-off and provisioning policy along with moderate recoveries. Restrictions on lending, under the PCA framework, have resulted in moderation of incremental slippages. Incremental slippages declined from 11.66 percent in FY2018 to 5.12 percent for FY2020 supporting overall decline in Gross NPA's. Slippages for H1 FY2021 stood at 0.24 percent partly also on account of the moratorium on asset classification.

IOB has been focusing on reducing their exposure towards corporate portfolio, reducing it from 31.52 percent as on March 31, 2019 to 20.61 percent as on September 30, 2020 mainly on account of increased delinquencies in key sectors such as Infrastructure, Power and Steel sector to which Indian Overseas Bank had significant exposure. The management's current underwriting strategy involves additional exposures to Retail, Agricultural and Micro, small and medium enterprises (MSME) segments which collectively accounted for about 73.54 percent of total advances as on September 30, 2020.

However, it is pertinent to mention that, the Supreme Court has currently restricted banks and financial institutions from classifying accounts as NPA and the latter therefore, need to maintain status-quo on the accounts; the actual trend of slippages will therefore, be understood only after a normalization in this regard. While IOB will continue to witness a broader level of stress across its various asset classes in the current operating environment, Acuite does not expect the bank to witness any major surge in delinquencies and NPAs in the near term.

• Sustainability of improvement in earning profile

IOB's profitability metrics had remained weak as a result of moderate asset quality. The Bank reported a net loss of Rs. 3738 Cr as on March 31, 2019 and Rs. 8,527 Cr as on March 31, 2020 on account of high credit costs, provisioning and write-offs. Return on Average Assets (RoAA) remained negative and deteriorated further from negative 1.50 percent as on March 31, 2019 to negative 3.34 percent as on March 31, 2020. Despite improvement in low cost deposit base, the bank's Net Interest Margin remained low as a result of decline in outstanding advances and reversal of interest income from FY2018 to FY2020. The decline in loan book has also led elevation in cost to income ratio which stood at 59 percent as on March 31, 2020.

However, the bank has shown initial signs of turnaround over the past three quarters, i.e. since March 2020, registering profits and decline in GNPA levels. The bank posted net profit of Rs. 144 Cr for 4Q FY20, Rs. 121 Cr for Q1 FY2021 and Rs. 148 Cr for Q2 FY2021. The improvement in profitability was mainly contributed by increase in treasury income (supported by the declining trend of yields). The bank's ability to maintain the momentum in treasury gains and improve recoveries from its written off accounts is crucial to sustain the improvement in profitability. The bank has been focusing on retail loans to boost its earning profile and containment of fresh slippages would also contribute towards moderate incremental provisions for non performing assets.

The ability of the bank to sustain the improvement in key parameters and profitability amidst the current challenging environment will be critical to the maintenance of a stable credit profile.

Rating Sensitivity

- Ownership of Govt and continuing support by way of capital infusion
- Improvement in capital adequacy levels
- Any significant changes in asset quality and profitability from the current levels
- Exit from PCA framework

Material Covenants

Not Applicable

Liquidity: Strong

The bank's liquidity position is supported by sovereign ownership and stable liability franchise. Its liquidity coverage ratio stood at 199.55 percent as on December 31, 2020 as against minimum regulatory requirement of 100 percent. Further, excess SLR stood at Rs. 28,049 Cr as on December 31, 2020.

Outlook: Stable

Acuite believes that Indian Overseas Bank will maintain a 'Stable' outlook on the back of continuing support from the Government of India and its stable liability franchise. The outlook may be revised to 'Positive' in case Indian Overseas Bank is able to demonstrate a significant and sustainable recovery in profitability and asset quality. The outlook may be revised to 'Negative' in case the bank faces challenges in maintaining the adequacy in its capital position and witnesses increased asset quality and profitability challenges in a post pandemic environment.

About the Rated Entity - Key Financials

Particulars	Unit	FY20 (Actual)	FY19 (Actual)
Interest Income	Rs. Cr	17,406	17,631
Interest Expense	Rs. Cr	12,103	12,352
Profit After Tax (PAT)	Rs. Cr	(8,527)	(3,738)
Deposits	Rs. Cr	2,22,952	2,22,534
Net Advances	Rs. Cr	1,21,333	1,32,598
Investments	Rs. Cr	79,416	66,932
Capital Adequacy	(%)	10.72	10.21
Return on Average Assts (RoAA)	(%)	(3.34)	(1.50)
Gross NPA's	(%)	14.78	21.97
Net NPA's	(%)	5.44	10.81

Status of non-cooperation with previous CRA (if applicable)

Not Applicable

Any other information

Not Applicable

Applicable Criteria

- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Banks and Financial Institutions - <https://www.acuite.in/view-rating-criteria-45.htm>
- Financial Ratios and Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History (Upto last three years)

None

*Annexure – Details of instruments rated

ISIN	Name of Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (Rs. Cr)	Ratings/ Outlook
-	Proposed Basel III Compliant Tier-II Bonds	Not Applicable	Not Applicable	Not Applicable	500.00	ACUITE AA-/Stable (Assigned)

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About Acuité Ratings & Research:

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