

India Ratings Revises Indian Overseas Bank's Outlook to Stable; Affirms 'IND AA-'

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India Ratings and Research (Ind-Ra) has taken the following rating actions on IOB Bank (IOB):

Instrument Type	Date of Issuance	ISIN	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier 2 bonds	24 September 2019	INE565A08035	9.08	24 September 2029	INR5	IND AA-/Stable	Affirmed; Outlook revised to Stable from Negative

Analytical Approach: Ind-Ra continues to factor in support from the government of India (GoI) to arrive at the rating. The GoI held 96.38% stake in IOB at end-September 2021 and the bank is of systemic importance to the government.

The Outlook revision reflects the strengthening of IOB's balance sheet, reasonable cushion to absorb the impact of the Covid-19 pandemic, and the fact that COVID-19-led disruptions have had only a moderate impact on the bank. Ind-Ra opines that the government's support to IOB has been demonstrated through regular infusion of equity over the last few years, which has helped the bank to step up provisions and strengthen its balance sheet. Ind-Ra expects IOB to continue receiving timely support from the GoI, if and when required (the agency does not envision any material requirement in the short-to-medium term), to meet the minimum regulatory capital requirements. Furthermore, IOB is out of Prompt Corrective Action (PCA) in September 2021, and hence, some of the restrictions placed by regulators would be eased, thereby improving the bank's competitiveness in the market.

Key Rating Drivers

Capital Buffers Strengthened through Regular Equity Infusions by GoI: IOB has been receiving regular equity infusions from the GoI (FY21: INR41 billion; FY16-FY20: INR235.34 billion), leading to a substantial improvement in its capital. Its common equity tier (CET)-I ratio stood at 12.84% at end-2QFY22 (FY21: 12.91%; FY20: 8.21%). Moreover,

with the sharp catch-up in the provisions coverage ratio over FY18-FY21, the need to provide for legacy non-performing assets (NPAs) has been taken care of, thereby reducing the pressure on profitability. Additionally, with the bank's return to profitability (profitable over the last seven quarters), internal accruals would bolster the capital buffers.

As per Ind-Ra's analysis, support from the GoI, in the form of capital infusions, could be warranted if slippages are higher than the bank's expectations and recoveries/upgrades continue to be weaker than the management expectations. Ind-Ra also opines that the bank's ability to raise additional tier-1 bonds at a competitive pricing could be limited; and hence, it would have to maintain a minimum CET-I of 9.5% (tier-1 would largely be the CET-I).

COVID-19 Impact Seems to be Moderate: While IOB's asset quality might be weaker than that of larger PSBs, the impact of COVID-19-related issues appears to be manageable for the bank. The credit cost of 3.0% for FY22, resulting from ageing provisions and the credit costs rising out of COVID-19, would be absorbed by the bank, given the steady pre-provision operating profit performance (FY21: 4.7%, 1HFY22: 4.0%). Moreover, IOB had written off loans amounting to about INR287 billion during FY19-FY21 (this is about 20% of its current net advances), and if recoveries pick up further, this could be a source of profitability, and hence, capital too. However, Ind-Ra does not expect the bank to witness losses similar to the levels it has recorded in the past.

Ind-Ra believes the improvement in the gross NPA (GNPA) ratio over last two years (FY21: 11.69%, FYE19: 21.97%) mainly due to write-offs (INR46.2 billion in FY21 and INR164.1 billion in FY20). Furthermore, the asset quality continued to improve in 1HFY22, with IOB's gross non-performing assets/net non-performing assets stood at 10.66%/2.77%, with provision coverage ratio (excluding technical write-offs) at 76.1%. However, the special mention accounts-2 pools accounted for 3.2% of the net advances at 2QFYE22, along with a COVID-19 restructuring pool of INR52.2 billion and emergency credit line guarantee scheme disbursements of INR24.0 billion (together 5.6% of the net advances), which could be the potential pool for slippages over the near-to-medium term.

Low Institutional Funding Benefits on Improvement in Cost of Funds: IOB has a strong presence in the southern part of India with a current and savings account (CASA) ratio of 42.57% in 2QFY22 (FY21: 42.52%, FY20: 40.26%). The stable CASA franchise is also benefitted by IOB's lead banker status in Tamil Nadu, which provides opportunities to avail business from government entities. An improvement in the liability profile is also led by CAGR decline in the loan book by 1.9% over FY19-FY21. The bank's target to further augment CASA ratio will lead to an improvement in its cost of deposits, which declined to 4.26% in 2QFY22 (FY15: 7.50%); the share of bulk deposits in the total deposits declined to 4.3% (36.5%) over the same period.

Liquidity Indicator - Adequate: IOB maintained surplus funding of 3.8% in the cumulative one-year bucket as a percentage of total assets in FY21. The bank also maintains 28.4% of the total assets in balances with the Reserve Bank of India and in government securities, which gives Ind-Ra the comfort that IOB is well-placed to meet its short-term funding requirements. IOB also had a comfortable liquidity coverage ratio of 166.33% in 1QFY22, significantly above the regulatory requirement.

Profitability Supported by Non-interest Income: IOB reported a net profit of INR8.31 billion for FY21, after cumulative losses over FY16-FY20 standing at INR248.8 billion, higher than the profits earned over FY12-FY15. The profitability in FY21 was largely supported by the income from treasury (INR18.2 billion; FY20: INR6 billion), which was about 31% of FY21 pre-provision operating profit. Ind-Ra expects the treasury yields to inch higher in the near term and accordingly, expects the treasury income, to be materially lower for the banking system in FY22 (1HFY22 down 57.99% yoy to INR3.97 billion). Furthermore, Ind-Ra believes that notwithstanding any major credit events such as the pandemic, the recoveries could remain elevated (compared to steady state) in FY22 and FY23 and aid bank's profitability.

Rating Sensitivities

Positive: Continued support from the GoI, consistent material gains in market share on both advances and deposits, manageable impact of COVID-19, increased profitability from the core lending operations, lower contribution to profitability by volatile income streams, maintaining of at least the existing levels of capital, improving provision cover and no material deterioration in the asset quality from 2QFY22 levels could lead to a positive rating action.

Negative: The Basel III Tier-2 bond rating are based on Ind-Ra’s expectation of support from the Gol (majority shareholder) to meet the minimum capital requirements. Any change in the majority Gol ownership or a change in the agency’s opinion regarding the Gol’s timely support for the bank which could be warranted in case of sharp drop in capitalisation or otherwise, result in a negative rating action or a rating watch.

Company Profile

IOB, established in 1937, is the 10th-largest public sector bank in India. The Gol is the single-largest shareholder of the bank with 96.38% ownership. As of 2QFY22, IOB had a network of 3,216 branches within India, four overseas offices across Singapore, Hong Kong, Colombo and Bangkok, and 3,224 ATMs and cash recyclers.

FINANCIAL SUMMARY

Particulars (INR billion)	FY21	FY20
Total assets	2,740	2,607
Total equity	169.5	161.5
Net profit	8.31	-85.3
Return on average assets (%)	0.3	-3.3
Equity/assets (%)	6.2	6.2
Capital adequacy ratio (%)	15.32	10.72
Source: IOB, Ind-Ra		

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	22 September 2021	23 September 2020	8 August 2019
Basel III tier 2 bonds	Long-term	INR5	IND AA-/Stable	IND AA-/Negative	IND AA-/Negative	IND AA-/Negative

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Basel III tier 2 bonds	Moderate

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APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Rating Bank Subordinated and Hybrid Securities

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