

India Ratings Revises Outlook on Indian Overseas Bank's Basel III Tier-II Bonds to Positive; Affirms 'IND AA-'

Feb 23, 2024 | Public Sector Bank

India Ratings and Research (Ind-Ra) has revised the Outlook on Indian Overseas Bank's (IOB) Basel III Tier-II bonds to Positive from Stable while affirming the rating at 'IND AA-' as follows:

Instrument Type	Date of Issuance	ISIN	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier 2 bonds*	-	-	-	-	INR11.65 (reduced from INR13.0)	IND AA-/Positive	Affirmed; Outlook revised to Positive from Stable

*Detailed in Annexure.

Analytical Approach: Ind-Ra continues to factor in the support available from the government of India (GoI) to arrive at the ratings. The GoI held a 96.38% stake in IOB at end-December 2023, indicating the bank's systemic importance to the government.

The Positive Outlook reflects the bank's improving capital position and operating buffers, indicating its increasing ability to maintain the market share and absorb the impact of any expected and unexpected increase in its credit costs. The Outlook revision also reflects a drastic reduction in IOB's adverse provisioning impact of legacy non-performing assets (NPAs) and an overall improvement in the lending environment especially for banks. These factors, in the agency's opinion, could boost IOB's profitability in the medium term and grow its share in advances and deposits over the medium term.

Key Rating Drivers

Strengthened Capital Buffers: IOB's capital buffers improved over the seven quarters ended 3QFY24 and the bank is now better placed than historically, with its tier-I capital (tier-1) ratio and capital adequacy ratio increasing to 13.95% and 16.80% at end-3QFY24 (FYE23:12.88%, 16.10%), respectively. Simultaneously, the bank's net NPAs reduced to about 0.62% at 3QFY24 (FYE21: 3.58%). Also, IOB's risk weighted assets to net advances decreased to 66.9% at 3QFY24 (FYE21: 87.7%), largely because of better capital efficiency, led by lending to high-rated corporates. Ind-Ra believes the manageable asset quality would enable the bank to maintain higher profitability over FY24-FY25 than that in the previous years. Ind-Ra believes the existing capital buffers are adequately placed to absorb any asset quality shocks.

After factoring in the elevated provisioning requirements in FY25, on account of potential slippages from

restructured accounts, the agency believes IOB's capital buffers will be adequate for growth requirements. Furthermore, with a sharp rise in provisions coverage ratio over FY18-FY23 (FY23: 76.8%; FY18: 46.6%), the need to provide for its legacy NPAs has been taken care of, reducing pressure on its profitability. Additionally, with the bank returning to the sustainable profitability, its internal accruals shall add to the capital buffers. Ind-Ra believes that the impact of Reserve Bank of India's circular in November 2023, on increasing risk weight requirements for unsecured consumer credit and for lending to the non-bank segment would be 30bp-40bp on CET 1 and easily absorbable, given its capital buffers.

Profitability on Improving Trend: IOB's profit increased significantly to about INR18.47 billion in 9MFY24 (FY23: INR21.04 billion; FY22: INR17.10 billion), mainly backed by a decline in its credit costs, growth in advances and improved net interest margins (NIMs) of 3.12% (FY21: 2.39%). The improvement in NIMs was led by faster repricing in advances than in deposits and a strong current and savings account (CASA) profile. The bank's credit cost (provision for NPAs to average net advances) reduced to 2.2% in FY23 (FY22: 2.9%; FY21: 4.1%). Over the near-to medium term, Ind-Ra expects IOB's credit costs to be absorbed by its likely steady-state operating profit (pre-provisioning operating profit to net advances: 9MFY24: 3.31%; FY23: 3.69%); hence, the bank is unlikely to post losses due to credit costs.

Liquidity Indicator – Adequate: IOB reported funding deficit of about 3.2% in the cumulative one-year bucket as a percentage of total assets in 3QFY24. The bank maintained about 23.5% of the total assets as balances with the Reserve Bank of India and 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 140.58% in 3QFY24, significantly above the regulatory requirement of 100%. If the deposit growth does not keep pace with its growth in advances, the bank may need to increasingly rely on wholesale sources, which could affect its liquidity.

Asset Quality Improving, but Yet to Stabilise: The bank's gross NPA ratio declined to 3.90% in 9MFY24 (FY23: 7.44%; FY22: 9.82%), mainly on account of huge write-offs of INR90.60 billion. The bank's provision coverage (net of technical write-offs) of about 84.57% at 3QFYE24 (FYE23: 76.79%; FYE22: 75.00%) and the net NPA levels stood at about 0.62% (1.83%; 2.65%), lower than that of its peers.

Furthermore, IOB's loans as a percentage of net advances stood at about 2.3% at 3QFYE24 that were restructured under the COVID-19 resolution framework. Ind-Ra believes its loans worth about INR17.04 billion, which have been supported by the Emergency Credit Line Guarantee Scheme could be source of further slippage. Also, IOB witnessed a gross slippage of about 1.0% (annualised) in 9MFY24 (FY23: 3.1%; FY22: 4.0%), in line with those of its peers. Ind-Ra believes the bank may not see significant net slippages in the medium term and the asset quality would be manageable over the near- to medium term.

Weak CASA Growth, but Sticky Liability Franchise: IOB had a liability franchise with a CASA ratio of 43.5% in 3QFY24 (FY23: 44.5%), helping it maintain the NIM. The overall deposits grew 8.0% yoy in 3QFY24 (FY23: negative 0.5%), with the CASA growing at 5.5% yoy (0.2%), due to its advances declining at CAGR of 4.3% over FY15-FY20, helping the bank accrue a sticky and granular deposit profile.

Rating Sensitivities

Positive: Sustained systemic importance reflected in the bank's improving market share in advances and deposits could lead to a positive rating action. A consistent improvement in the bank's standalone capital and profitability buffers (with increased profitability from the core lending operations), while maintaining peer-comparable or better asset quality, and an overall improvement in the operating environment could also lead to a positive rating action.

Negative: The Basel III tier-2 bond rating is based on Ind-Ra's expectation of continuous support from the Gol to meet the minimum capital requirements. Any change in the Gol's 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 a sharp drop in the capitalisation or otherwise, could result in a negative rating action or a rating watch. Also, sustained deterioration in the operating performance and continuing pressure on the asset quality could lead to a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on IOB, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra’s ESG Relevance Disclosures, please [click here](#). For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please [click here](#).

Company Profile

IOB, established in 1937, is the ninth-largest public sector bank in terms of deposits in India. The Gol is the single-largest shareholder of the bank with a 96.38% ownership as of December 2023.

FINANCIAL SUMMARY

Particulars (INR billion)	9MFY24	FY23	FY22
Total assets	3,441	3,130	2,993
Total equity	271.6	252.6	230.0
Net profit	18.5	21.0	17.1
Return on average assets (%)	0.75	0.69	0.60
Capital adequacy ratio (%)	16.80	16.10	13.83
Source: IOB, Ind-Ra			

Non-Cooperation with previous rating agency

Not applicable

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.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities
Rating FI Subsidiaries and Holding Companies
Evaluating Corporate Governance
The Rating Process

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook				
	Rating Type	Rated Limits (billion)	Rating	27 February 2023	28 February 2022	13 December 2021	22 September 2021	23 September 2020
Basel III Tier 2 bonds	Long-term	INR11.65	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Negative	IND AA-/Negative

Annexure

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Basel III Tier 2 bonds	INE565A08043	31 March 2022	8.60	31 March 2032	INR6.65	IND AA-/Positive
Basel III Tier 2 bonds	INE565A08035	24 September 2019	9.08	24 September 2029	INR5	IND AA-/Positive
				Total utilised	INR11.65	

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Basel III Tier-II bonds	Moderate

For details on the complexity level of the instrument, please visit <https://www.indiaratings.co.in/complexity-indicators>.

Contact

Primary Analyst

Ankit Jain
 Senior Analyst
 India Ratings and Research Pvt Ltd
 Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
 +91 22 40356160
 For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst

Aishwary Khandelwal
 Senior Analyst
 +91 22 40001700

Media Relation

Ameya Bodkhe
 Marketing Manager
 +91 22 40356121

About India Ratings and Research: India Ratings and Research (Ind-Ra) is committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

All credit ratings assigned by india ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: <https://www.indiaratings.co.in/rating-definitions>. In addition, rating definitions and the terms of use of such ratings are available on the agency's public website www.indiaratings.co.in. Published ratings, criteria, and methodologies are available from this site at all times. India ratings' code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the code of conduct section of this site.