India Ratings & Research
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India Ratings Upgrades Indian Overseas Bank's Basel III Tier 2 Bonds to 'IND AA'; Outlook Stable

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India Ratings and Research (Ind-Ra) has upgraded Indian Overseas Bank's (IOB) Basel III Tier 2 Bonds to 'IND AA' from 'IND AA-'. The Outlook is Stable. The detailed rating action is as follows:

Details of Instruments

Instrument Type	Date of Issuance	ISIN	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating Assigned along with Outlook/Watch	Rating Action
Basel III Tier 2 bonds*	-	-	-	-	INR11.65	IND AA/Stable	Upgraded

*Details in Annexure

Analytical Approach

Ind-Ra continues to factor in the support available to IOB from the government of India (GoI) to arrive at the rating. The GoI's 96.38% stake in IOB at end-December 2024 indicates the bank's systemic importance to the government. The Basel III tier-2 bond rating is based on Ind-Ra's expectation of a continuous support from the GoI to meet the minimum capital requirements.

Detailed Rationale of the Rating Action

The upgrade reflects IOB's improved capital position and operating buffers including pre-provisioning operating profit /credit cost in 1HFY25, indicating its increasing ability to absorb the impact of expected and unexpected credit costs. The upgrade also reflects a continuous improvement in the bank's asset quality, as evidenced by its declining credit cost, adequate provision coverage, and manageable Special Mention Accounts II. The rating also factors in IOB's modest current account savings account (CASA) franchise, and strong deposit growth witnessed in 1HFY25. These factors, in the agency's opinion, could help sustain IOB's improved profitability in the medium term.

List of Key Rating Drivers

Strengths
- Strengthened capital buffers, improved internal accruals
- Improved liability franchise
- Improving asset quality

Weaknesses
- Evolving profitability

Detailed Description of Key Rating Drivers

Strengthened Capital Buffers: IOB's capital buffers continued to improve at 2QFYE25 and the bank is now better placed than historically, with its tier-I capital (tier-1) ratio increasing to 14.75% (FYE24: 14.47%; FYE23: 12.88%) and capital adequacy to 17.45% (17.28%; 16.10%). The bank achieved a return on assets (ROA) of 0.82% in 2QFY25 (FY20-

FY23: average -0.4%) and intends to gradually improve it to above 1.0% over the medium term. This also needs to be viewed in context of the bank's net non-performing assets (NPAs) reducing to about 0.47% at 2QFYE25 (FYE21:3.6%). Furthermore, IOB's risk weighted assets to net advances decreased to 65.69% at 2QFYE25 (FYE21: 87.7%), largely because of improved capital efficiency led by lending to better rated corporates.

After factoring in the elevated provisioning requirements in FY25 on account of potential slippages, Ind-Ra believes IOB's capital buffers will be adequate for growth requirements. Furthermore, with a sharp rise in provisions coverage ratio over FY21-FY24 (1HFY25: 83.05%; FY24: 82.1%; FY23: 76.8%; FY21: 72%), the need to provide for its legacy NPAs has been taken care of, thus reducing pressure on its profitability. While the capital base is adequate presently, the agency believes there is a need to build buffers ahead of the implementation of the expected credit loss norms; this will be a key rating monitorable.

Improved Liability Franchise: The bank's CASA deposit ratio stood at 42.44% in 2QFY25 (FY24: 43.9%; FY23: 43.7%), remaining largely stable, contrary to the industry-wide trend where other banks have seen a sharp drop in their CASA base. However, the granularity of the deposit is moderate, as the top 20 deposits accounted for 6.2% of the total deposit as of 2QFY25. While the deposit growth has been lacklustre between FY21 and FY24 with deposits growing at a CAGR of 6.0%, the bank's low loan-deposit ratio (LDR) provided headroom to grow its loan book. However, in FY24, its LDR increased to 74.6% and hovered around similar levels in 1HFY25. Consequently, the bank is focusing on deposit mobilisation and registered deposit growth of 13.8% at 1HFYE25, higher than the net advance growth of 12.3% during the same period.

Ind-Ra expects IOB to restrict its LDR below 80% over the near-to-medium term. Thus, the bank's ability to maintain loan growth in the face of continued competition for mobilisation of deposits would be a key monitorable in the near-to-medium term.

Improving Asset Quality: The bank's gross NPA ratio declined to 2.72% in 1HFY25 (FY24: 3.1%; FY23: 7.44%), mainly on account of huge write-offs of INR72.14billion in FY24. The provision coverage (net of technical write-offs) stood at about 83.05% at 1HFYE25 (FYE24:82.1%; FYE23: 76.8%) and the net NPA at about 0.47% (0.57%; 1.83%), lower than that of its peers.

Furthermore, IOB's restructured book accounts for only around 1.7% of the total advances. The bank's gross slippage was lower that most of it peers at 0.5% (annualised) in 2QFY25 (FY24: 0.9%; FY23: 3.1%) and net slippage (gross slippage less upgrades and recoveries) was negative at 0.7% (negative 4.1%; negative: 0.9%). Furthermore, the bank's exposure to the unsecured loan segment within the retail segment is just 3%. In the service industry, the bank had no exposure to non-bank financial company (NBFC)-microfinance institutions and NBFC-housing finance companies, while other NBFCs accounted for 7% of the total book in 1HFY25. Hence, Ind-Ra believes the bank may not see significant net slippages in FY25 and the asset quality is likely to continue to improve and would be manageable over the near-to-medium term.

Evolving Profitability: IOB's profit increased significantly to about INR14.1 billion in 1HFY25 (FY24: INR26.6 billion; FY23: INR21 billion), mainly backed by a decline in its credit costs, growth in advances and improved net interest margins (NIMs) of 3.08% (FY21: 2.55%). The improvement in NIMs was led by sharp rise in LDR and faster repricing in advances than in deposits, and a healthy proportion of low-cost CASA deposit in total deposits. The bank's credit cost (provision for NPAs/average net advances) was 2.04% in 1HFY25 (FY24: 1.75%; FY23: 2.2%). 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: 1HFY25: 3.5%; FY24: 3.5%; FY23: 3.7%); hence, the bank is unlikely to post losses due to credit costs.

Liquidity

Adequate: IOB reported a funding deficit of about 3.9% in the cumulative one-year bucket as a percentage of total assets in 1HFY25. The bank maintained about 30.7% 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 125.8% in 2QFY25, higher than regulatory requirement of 100%.

Rating Sensitivities

Positive: Events that could, individually or collectively, result in a positive rating action are:
- sustained systemic importance reflected in the bank's improving market share in advances and deposits;
- 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.

Negative: Events that could, individually or collectively, result in a negative rating action are:
- sustained deterioration in the operating performance and continuing pressure on the asset quality;
- any change in the GoI's ownership or a change in the agency's opinion regarding the GoI's timely support to the bank, which could be warranted in case of a sharp drop in the capitalisation or otherwise.

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.

About the Company

IOB, established in 1937, is the ninth-largest public sector bank in terms of deposits in India. The GoI is the single-largest shareholder of the bank with a 96.38% ownership as of December 2024.

Key Financial Indicators

Particulars (INR billion)	1HFY25	FY24	FY23
Total assets	3766	3520	3,130
Total equity	284.7	279.4	252.6
Net profit	14.1	26.6	21.0
Return on average assets (%)	0.82	0.80	0.69
Capital adequacy ratio (%)	17.5	17.3	16.10
Source: IOB, Ind-Ra			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook				
	Rating Type	Rated Limits (billion)	Rating	23 February 2024	27 February 2023	28 February 2022	13 December 2021	22 September 2021
Basel III tier 2 bonds	Long-term	INR11.65	IND AA/Stable	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Negative

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Basel III Tier 2 bonds	Low

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

Annexure

Instrument Type	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/Stable
Basel III Tier 2 bonds	INE565A08035	24 September 2019	9.08	24 September 2029	INR5	IND AA/Stable
				Total utilised	**INR11.65**	
Source: NSDL, IOB						

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Rating Bank Subordinated and Hybrid Securities

Evaluating Corporate Governance

Financial Institutions Rating Criteria

The Rating Process

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