

STOCK DATA

Market Cap	Rs92.4bn.
Book Value per share	Rs71.1
Eq Shares O/S (F.V. Rs.10)	544.8mn.
Median Vol (12 mths)	368,172 (BSE+NSE)
52 Week High/Low	Rs229/89
Bloomberg Code	IOB@IN
Reuters Code	IOB.BO

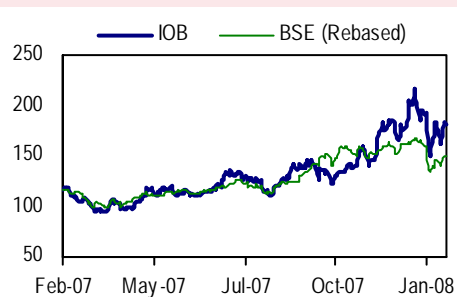
SHAREHOLDING PATTERN (%)

Qtr. Ended	Jun-07	Sep-07	Dec-07
Promoter	61.2	61.2	61.2
MFs /FI	5.8	6.0	6.3
FII/NRI/OCB	18.2	19.3	19.4
PCB	1.3	1.1	1.0
Indian Public/Others	13.5	12.3	12.1

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(5.1)	9.2	43.7
Relative	10.2	23.7	20.5

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

Indian Overseas Bank (IOB) reported a moderate growth of 8.4% YoY in Net Interest Income (NII) which was in line with our expectation due to fall in margins and spike in cost of funds.

The bank's net profit grew 25% YoY to Rs3.08bn due to strong performance in non interest income and lower provisioning attributed to improving asset quality as well as write back of provisions.

● **NIM under pressure**

Surge in interest expense by 64% to Rs14.2bn, mobilization of high cost deposit in the first half of current fiscal, moderation in NII growth and shrinking CASA brought down the margin by 60 bps to 3.11%.

● **Moderate growth in core business**

Advances and deposits witnessed subdued incremental growth of 14% and 14.6% in the current fiscal. Hence, C-D ratio has also declined to 69% from 75%.

● **Net profit growth**

Despite slower growth in income, net profit increased by 25% YoY to Rs 3.1bn mainly due to write back of provisions and decline in overall provisioning requirements. Improvement in asset quality also resulted in lower provisioning.

VALUATION AND RECOMMENDATION

IOB has higher bulk deposit due to which it has taken a sharp hit on the margins. Deposit growth outpaced credit offtake in Q2FY08 and which has remained stagnant in the quarter under review. We believe margins would continue to remain under pressure until high cost deposits mature.

We value the stock at a sustainable RoE of 22.74% (CoE-14%; g-7%), fair Adj. PBV multiple of 2.25. With these assumptions, we arrive at FY09 price target of Rs215, which represents 34% upside from the CMP. Hence, we maintain our 'BUY' recommendation on the stock.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Jun-07	Sep-07	Dec-07	2006	2007	2008E	2009E	2010E
Op Income	7,706	8,066	8,755	27,954	29,479	34,999	39,570	45,825
YoY Gr. (%)	0.5	14.6	17.8	12.0	5.5	18.7	13.1	15.8
Op Profit	4,092	4,580	4,931	15,338	15,600	19,716	22,890	27,413
Op Marg.(%)	21.4	21.8	21.5	29.9	25.1	22.9	22.1	23.1
Net Profit	2,685	3,197	3,082	7,833	10,084	11,843	13,389	15,003
Eq. Capital	5,448	5,448	5,448	5,448	5,448	5,448	5,448	5,448

KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008E	2009E	2010E
Dil. EPS (Rs)	14.4	18.5	21.7	24.6	27.5
Adj. BV (Rs)	56.3	71.5	83.8	95.8	110.9
ROAA (%)	1.42	1.42	1.30	1.23	1.19
ROANW (%)	28.5	29.1	27.1	24.7	22.7
P/E (X)	11.2	8.7	7.4	6.6	5.8
P/ABV (X)	2.86	2.25	1.92	1.68	1.45

PERFORMANCE OVERVIEW

Modest NII Growth

High interest cost and low credit growth led to decline in NIM...

Indian Overseas Bank (IOB) reported a subdued incremental growth in advances and deposits of 14% and 14.6% to Rs546bn and Rs788bn respectively. The Bank witnessed sluggish NII expansion of 8.4% to Rs6.55bn on account of surge in interest expense by 63.5% to Rs14.19bn and slower growth in advances. Accretion of high cost deposits in the first half of the current fiscal has resulted in high interest expense. CASA ratio has fallen by 420 bps to 30.8% which has resulted in the cost of funds of IOB inching upwards by 134bps YoY to 6.7% in Q3FY08.

Pressure on NIM to continue

NIM for the current quarter has dipped by 61bps YoY and 29bps QoQ to 3.11% due to spike in cost of funds and declining credit - deposit ratio. Majority of the advance portfolio of IOB were given at a fixed rate due to which this part of portfolio could not be repriced upwards. The bank maintains that by improving share of low cost deposits and increasing NII, it will be able to improve the margins.

High Non-Interest income growth

Net profit enhances on the back of high other income and low provisioning...

Non-interest income surged 63% to Rs2.2bn led by higher growth in core non-interest income. Excluding treasury gains/losses the expansion has been even higher at 1.5 times YoY. IOB has strong franchise network in South India and it has tie ups with several mutual funds and insurance firms to distribute their products. Thus, we maintain that non interest income will continue to remain robust for the Bank.

Write back of provisioning, lower provisioning requirements on account of improving asset quality has resulted in provisions declining by 44% to Rs367mn. During Q3FY08, the bank had write back of investment provisions of Rs300mn. Gross and Net NPA's have declined by 67 and 12 bps YoY to 1.87% and 0.36% respectively.

INVESTMENT ARGUMENT

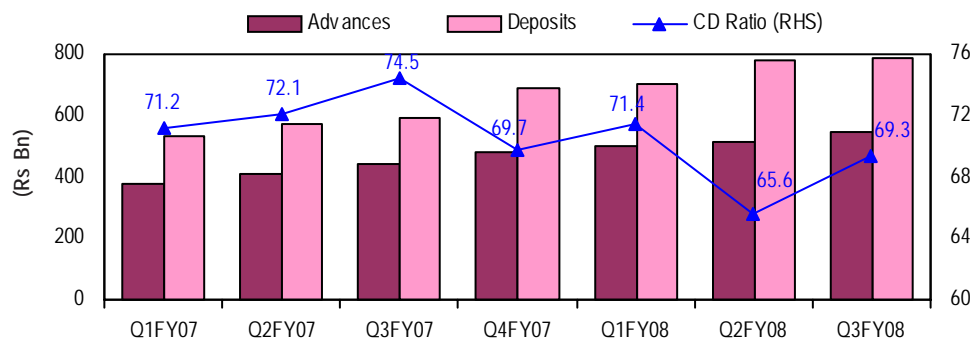
NIM would remain under pressure until bulk deposits get replaced with low cost deposits...

We expect IOB to achieve a moderate CAGR in credit of 20% between FY08 - FY10. NIM is expected to remain under pressure until the high cost bulk deposits mature and the Bank is able to replace them with low cost deposits. Also, healthy growth in advances would support the margins. We estimate NIM to remain ~3% by FY10.

CASA ratio of the Bank has drastically fallen from last year and we estimate marginal improvement in the same to hover ~34-35% in the next 3 fiscal. CASA remains key focus of the bank as an effort to maintain their margin at current levels.

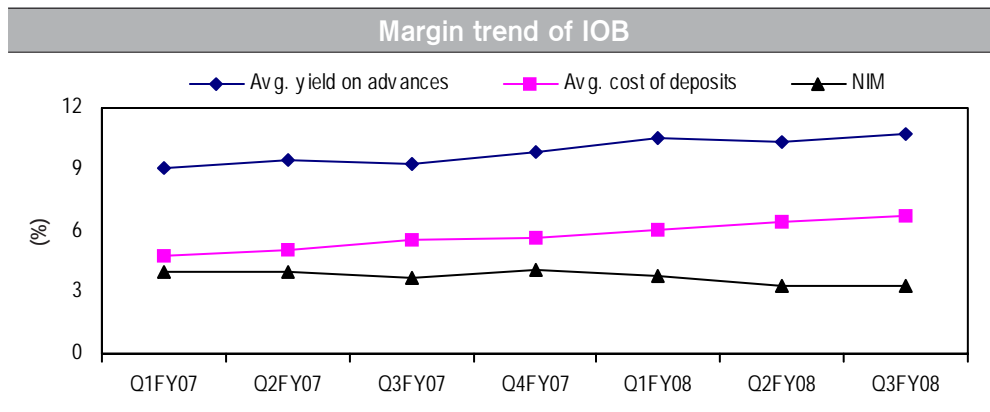
Rising delinquencies has also been a major cause of concern in FY07. We expect the delinquencies to show an upward trend due to rising interest rates and the high credit growth of ~35% YoY during the last 2 fiscal. The delinquencies as a percentage of previous year end advances have risen from 1.89% in FY06 to 2.04% during FY07. We have factored in delinquencies at 2.08% - 2.20% during the next three fiscal, which is going to keep LLP high ~ 0.24 of average assets in FY09. Any worsening of loan slippages over and above these levels would lead to further deterioration in RoA & hence, RoE.

Trend in business growth of IOB



Source: PINC Research & Company Data

CASA to remain focus area while rising delinquencies to remain a concern...



Source: PINC Research & Company Data

OUTLOOK

Under the current set of assumptions, we expect the bank to achieve net profit CAGR of 12.5% during FY08-10. We project a decline in RoA to 1.23% in FY09 due to pressure on the margins and high LLP. This would lead to RoE contracting from 29.1% in FY07 to 24.75% by FY09.

IOB was the only bank among Indian frontline banks to consistently deliver RoE of over 28% for the past 5 fiscals. However, the same has been declining due to earnings slowdown going forward due to the higher profit base of previous years and shrinking margins and therefore we expect pressure on operations to continue. IOB carries large proportion on investments in the AFS category. Liquidation of investments in the AFS category, given that interest rates would fall going forward, would provide an upside to our estimates.

VALUATION

IOB has higher bulk deposit due to which it has taken a sharp hit on the margins. Deposit growth outpaced credit offtake in Q2FY08 and currently growth in business has become stagnant for the bank. We believe margins would continue to remain under pressure until high cost deposits mature and get replaced by low cost deposits.

We value the stock at a sustainable RoE of 22.74% (CoE-14%; g-7%), fair Adj. PBV multiple of 2.25. With these assumptions, we arrive at FY09 price target of Rs215 which represents 24% upside from the CMP. Hence, we maintain our 'BUY' recommendation on the stock .

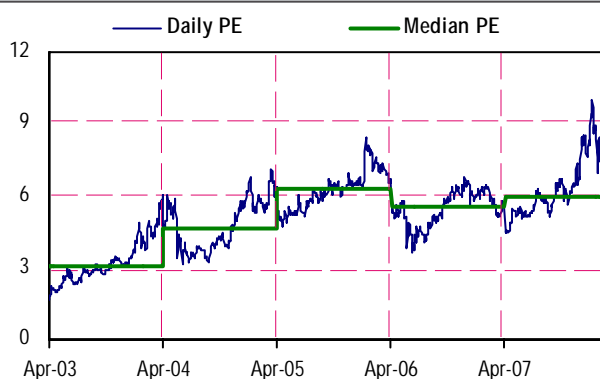
Company description

IOB was founded on 10th February 1937. It is the only bank which had a unique distinction of starting overseas banking service on the inaugural day itself with a branch at Rangoon in Burma (now Myanmar) IOB currently ranks 10th among all the banks in India in terms of volume of business. At present, the Bank has 5 overseas branches in cities like Singapore (Branch & Remittance Center), Colombo, Hong Kong (2 Branches) & Seoul. In India it has a pre-dominant presence in the southern region and traditionally it had high NIM and RoE in the industry.

Financial Results for the quarter & nine months ended 31 December 2007

Particulars (Rs Mn)	Quarter Ended			Nine Months Ended			Year Ended
	31/12/07	31/12/06	Gr %	31/12/07	31/12/06	Gr %	31/03/07
Interest on Advances	14,279	9,924	43.9	40,228	27,652	45.5	39,010
Interest on Investments	5,938	4,362	36.1	16,557	12,187	35.9	17,033
Interest on balances/others	542	451	20.0	1,739	1,028	69.3	2,278
Interest Income	20,759	14,737	40.9	58,524	40,867	43.2	58,321
Interest Expenses	14,199	8,686	63.5	38,553	22,941	68.0	32,713
Net Interest Income	6,560	6,051	8.4	19,971	17,926	11.4	25,608
Other Income	2,195	1,380	59.0	4,555	4,211	8.2	3,871
Operating Income	8,755	7,431	17.8	24,527	22,137	10.8	29,479
Employee cost	2,598	2,133	21.8	7,268	6,888	5.5	9,311
Other operating expense	1,226	982	24.8	3,656	3,020	21.0	4,567
Operating Expenditure	3,824	3,116	22.7	10,924	9,909	10.2	13,878
Operating profit	4,931	4,316	14.3	13,603	12,229	11.2	15,600
Provisions and Contingencies	367	651	(43.7)	1,070	2,292	(53.3)	1,866
PBT	4,564	3,665	24.5	12,533	9,937	26.1	13,734
Provision for current tax	1,482	1,197	23.9	3,569	2,750	29.8	3,650
Net Profit	3,082	2,468	24.9	8,964	7,187	24.7	10,084
Equity capital	5,448	5,448		5,448	5,448		5,448
EPS for the period(Rs)	5.7	4.5		16.5	13.2		18.5
OPM (%)	21.5	26.8		21.6	27.1		25.1
NPM (%)	13.4	15.3		14.2	15.9		16.2
NIM	3.11	4.01		3.30	3.91		4.10

Median PE v/s Daily PE



PE Band



Income Statement	2005	2006	2007	2008E	2009E	2010E
Interest Income	39,511	44,063	58,321	79,766	94,670	107,903
Interest Expense	20,955	23,391	32,713	51,281	63,998	73,053
Net Interest Income	18,555	20,672	25,608	28,485	30,672	34,850
Other Income	6,398	7,282	3,871	6,514	8,899	10,976
Total Operating Income	24,953	27,954	29,479	34,999	39,570	45,825
Total Operating Expense	11,585	12,616	13,878	15,284	16,681	18,412
Operating profit	13,368	15,338	15,600	19,716	22,890	27,413
Provisions & contingencies	3,498	5,482	1,866	2,300	3,200	5,350
PBT & extraordinary items	9,870	9,856	13,734	17,416	19,690	22,063
(-) Tax provision	3,356	2,023	3,650	5,573	6,301	7,060
Net Profits	6,514	7,833	10,084	11,843	13,389	15,003
Fully diluted Eq. sh. O/s (mn no)	544.8	544.8	544.8	544.8	544.8	544.8
75% Adj. Book Value (Rs)	45	56	71	84	96	111
Basic EPS (Rs)	12.0	14.4	18.5	21.7	24.6	27.5

Balance Sheet	2005	2006	2007	2008E	2009E	2010E
<i>Equity Share Capital</i>	5,448	5,448	5,448	5,448	5,448	5,448
<i>Reserves & Surplus</i>	20,304	26,326	34,456	44,200	55,302	67,829
Net worth	25,752	31,774	39,904	49,648	60,750	73,277
Deposits	442,412	505,293	687,404	850,499	986,285	1,143,868
Borrowings & other liability	39,986	56,511	95,260	103,063	118,794	143,290
Capital Employed	508,150	593,578	822,568	1,003,210	1,165,828	1,360,436
Cash & balances	49,540	37,072	89,793	110,207	111,329	128,929
Advances	252,052	347,562	470,603	606,690	737,396	877,526
Investments	190,147	189,523	239,745	260,528	288,029	321,068
Fixed Assets	4,523	4,577	5,107	5,342	5,393	5,448
Other Assets	11,888	14,844	17,321	20,444	23,681	27,465
Total Assets	508,150	593,578	822,568	1,003,210	1,165,828	1,360,436

ROE Analysis	2005	2006	2007	2008E	2009E	2010E
% of average assets						
Interest Income	8.05	8.00	8.24	8.74	8.73	8.54
Interest Expense	4.27	4.25	4.62	5.62	5.90	5.78
Net Interest Income	3.78	3.75	3.62	3.12	2.83	2.76
Fee Income	0.71	0.70	0.76	0.62	0.56	0.52
Treasury and other income	0.59	0.62	(0.21)	0.09	0.26	0.35
Operating Income	5.09	5.07	4.16	3.83	3.65	3.63
Staff Cost	1.72	1.62	1.31	1.10	1.00	0.95
Overheads and Depreciation	0.64	0.67	0.65	0.57	0.54	0.51
Operating Costs	2.36	2.29	1.96	1.67	1.54	1.46
Pre-provision operating profit	2.72	2.78	2.20	2.16	2.11	2.17
Loan Loss provisions	0.60	0.28	0.19	0.19	0.24	0.38
Other provisions and exceptionals	0.11	0.72	0.07	0.07	0.06	0.05
Total provisions	0.71	1.00	0.26	0.25	0.30	0.42
Profit Before Taxes	2.01	1.79	1.94	1.91	1.82	1.75
Taxes	0.68	0.37	0.52	0.61	0.58	0.56
RoAA	1.33	1.42	1.42	1.30	1.23	1.19
Avg. Assets/Avg. net worth	22.49	20.07	20.44	20.93	20.04	19.15
RoE	29.85	28.55	29.11	27.15	24.75	22.74

Key Ratios	2005	2006	2007	2008E	2009E	2010E
OPM (%)	29.1	29.9	25.1	22.9	22.1	23.1
NPM (%)	14.2	15.3	16.2	13.7	12.9	12.6
ROA (%)	1.33	1.42	1.42	1.30	1.23	1.19
ROANW (%)	29.9	28.5	29.1	27.1	24.7	22.7
Credit - Deposit (%)	57.0	68.8	68.5	71.3	74.8	76.7
Invest. - Deposit (%)	43.0	37.5	34.9	30.6	29.2	28.1
Cost -Income (%)	46.4	45.1	47.1	43.7	42.2	40.2
Yield on Advances (%)	9.20	8.77	9.54	10.20	9.88	9.82
Yield on Investments (%)	9.17	8.98	8.07	9.00	8.92	7.90
Cost of Deposits (%)	4.65	4.61	4.86	5.86	6.20	6.06
NIM (%)	4.27	4.13	3.99	3.46	3.12	3.01
DPS (Rs)	2.4	2.6	3.0	3.2	3.5	3.8
GNPA (%)	5.28	3.44	2.34	2.86	3.62	4.39
NNPA (%0	1.32	0.66	0.56	1.23	1.97	2.52
Book Value (Rs.)	45	56	71	89	110	133
75% Adj. Book Value (Rs.)	45	56	71	84	96	111
P/E (x)	13.5	11.2	8.7	7.4	6.6	5.8
P/BV (x)	3.60	2.87	2.27	1.81	1.47	1.21
P/ABV (x)	3.56	2.86	2.25	1.92	1.68	1.45

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