



Indian Overseas Bank

| | |
|--------------------|--------------|
| STOCK INFO. | BLOOMBERG |
| BSE SENSEX: 15,235 | IOB IN |
| | REUTERS CODE |
| S&P CNX: 4,445 | IOBK.BO |

27 July 2007

Buy

Previous Recommendation: Buy

Rs126

| | |
|---------------------|--------|
| Equity Shares (m) | 544.8 |
| 52-Week Range | 140/80 |
| 1,6,12 Rel.Perf.(%) | 2/2/7 |
| M.Cap. (Rs b) | 68.5 |
| M.Cap. (US\$ b) | 1.7 |

| YEAR | NET INCOME | PAT | EPS | EPS | P/E | P/BV | CAR | ROE | ROA | P/ABV |
|-------|------------|--------|------|------------|-----|------|------|------|-----|-------|
| END | (RS M) | (RS M) | (RS) | GROWTH (%) | (X) | (X) | (%) | (%) | (%) | (X) |
| 3/07A | 29,478 | 10,084 | 18.5 | 28.7 | 6.8 | 1.8 | 13.3 | 28.1 | 1.4 | 1.8 |
| 3/08E | 35,441 | 11,985 | 22.0 | 18.8 | 5.7 | 1.4 | 12.0 | 26.8 | 1.3 | 1.5 |
| 3/09E | 42,116 | 14,396 | 26.4 | 20.1 | 4.8 | 1.1 | 11.7 | 25.9 | 1.3 | 1.2 |

On back of strong loan growth, but lower margins, 1QFY08 NII grew by 23% YoY to Rs7.1b. PAT grew 21% YoY to 2.7b. Core fee income grew strongly by 26% YoY while treasury profits declined 90% YoY. Asset quality continues to be robust despite faster asset growth and increased lending rates.

- ☞ Net interest income up by 23% YoY, NIMs under pressure
- ☞ Strong balance sheet growth continues
- ☞ Core fee income growth up 26% YoY
- ☞ Asset quality remains robust – net NPA at 0.5%
- ☞ CAR comfortable at 13.3%; Tier I at 8.4%

Over the last several quarters, IOB has been the most consistent state-owned bank on various operating parameters. The bank has also managed its bond portfolio and asset quality relatively better than other banks. Its RoE of 25%+ is one of the highest in the sector. We expect earnings growth to remain strong. The stock trades at 4.8x FY09E EPS and 1.1x FY09E BV which translates to RoE of 26% in FY09E. We place IOB as one of our top picks in the sector and believe it can command premium valuations over other banks. Reiterate **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

| | FY07 | | | | FY08E* | | | | FY07** | FY08E** |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| | 1Q* | 2Q | 3Q | 4Q | 1Q | 2QE | 3QE | 4QE | | |
| Interest Income | 12,409 | 13,721 | 14,737 | 17,454 | 18,462 | 18,924 | 19,302 | 19,994 | 58,321 | 76,681 |
| Interest Expense | 6,654 | 7,602 | 8,686 | 9,771 | 11,372 | 11,656 | 11,831 | 12,140 | 32,713 | 46,999 |
| Net Interest Income | 5,755 | 6,119 | 6,051 | 7,682 | 7,090 | 7,267 | 7,471 | 7,854 | 25,608 | 29,683 |
| % Change (Y-o-Y) | 19.1 | 18.3 | 15.1 | 42.0 | 23.2 | 18.8 | 23.5 | 2.2 | 23.9 | 15.9 |
| Other Income | -342 | 1,520 | 1,980 | 1,905 | 616 | 1,400 | 1,800 | 1,943 | 3,870 | 5,759 |
| Net Income | 5,413 | 7,639 | 8,031 | 9,587 | 7,706 | 8,667 | 9,271 | 9,797 | 29,478 | 35,441 |
| % Change (Y-o-Y) | -18.6 | 10.4 | 17.1 | 27.3 | 42.4 | 13.5 | 15.4 | 2.2 | 5.5 | 20.2 |
| Operating Expenses | 3,302 | 3,491 | 3,116 | 3,970 | 3,614 | 3,805 | 4,050 | 4,425 | 13,878 | 15,895 |
| Operating Profit | 2,111 | 4,148 | 4,916 | 5,618 | 4,092 | 4,862 | 5,221 | 5,372 | 15,600 | 19,546 |
| Other Provisions | -554 | 541 | 1,251 | 1,820 | 620 | 700 | 950 | 630 | 1,866 | 2,900 |
| Tax Provisions | 445 | 1,108 | 1,197 | 900 | 787 | 1,200 | 1,300 | 1,374 | 3,650 | 4,661 |
| Net Profit | 2,220 | 2,499 | 2,468 | 2,898 | 2,685 | 2,962 | 2,971 | 3,368 | 10,084 | 11,985 |
| % Change (Y-o-Y) | 21.2 | 25.9 | 25.1 | 41.7 | 20.9 | 18.5 | 20.4 | 16.2 | 28.7 | 18.8 |
| Cost to Income Ratio (%) | 61.0 | 45.7 | 38.8 | 41.4 | 46.9 | 43.9 | 43.7 | 45.2 | 47.1 | 44.8 |
| Interest Expense/Interest Income (%) | 53.6 | 55.4 | 58.9 | 56.0 | 61.6 | 61.6 | 61.3 | 60.7 | 56.1 | 61.3 |
| Other Income/Net Income (%) | -6.3 | 19.9 | 24.7 | 19.9 | 8.0 | 16.2 | 19.4 | 19.8 | 13.1 | 16.2 |

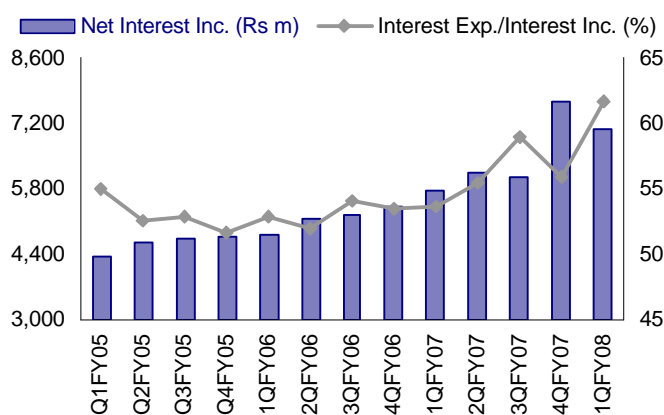
E: MOST Estimates; * Includes results of BhOB; **Amortization on HTM investments & transfer losses on AFS to HTM included in Other income

On back of strong loan growth, but lower margins, 1QFY08 NII grew by 23% YoY to Rs7.1b. PAT grew 21% YoY to 2.7b. Core fee income grew strongly by 26% YoY while treasury profits declined 90% YoY. Asset quality continues to be robust despite faster asset growth and increased lending rates.

Net interest income up by 23% YoY

IOB has grown its NII by 23% in 1QFY07 to Rs7.1b on account of strong loan growth but lower margins. NIM declined by 30bp YoY in 1QFY08 to 3.7%. Yield on advances improved 144bp to 10.5% while cost of deposits increased by 115bp YoY. Yield on investments, in line with expectations declined YoY by 41bp to 8% in 1QFY08. Management has guided for asset growth slowing down going forward and sustaining NIM at current levels.

TREND IN NII



Source: Company/ Motilal Oswal Securities

BREAK-UP ON MOVEMENT OF NIMS (%)

| | 1QFY07 | 4QFY07 | FY07 | 1QFY08 |
|----------------------|-------------|-------------|-------------|-------------|
| Avg Yield on Adv. | 9.05 | 9.58 | 9.06 | 10.49 |
| Avg Yield on Inv. | 8.41 | 8.13 | 7.91 | 8.00 |
| Avg Cost of Deposits | 4.78 | 5.24 | 4.89 | 5.93 |
| NIMs | 4.01 | 4.16 | 3.82 | 3.71 |

Source: Company/Motilal Oswal Securities

Strong balance sheet growth continues

Gross advances grew 28% YoY to Rs486b, while deposits grew 32% to Rs702b. On a QoQ basis, advances increased

by 3% while deposits increased by 2%. CASA ratio continues to decline for the bank. CASA ratio reduced to 32% in 1QFY08 from 38% a year ago and 35% in 4QFY07. Management attributed this fall to a shift of deposits from savings to term on account of higher interest rates offered for retail depositors. IOB continues to offer one of the highest rates of 9.6% (10.35% for senior citizens) for retail depositors on specific maturities. A sharp decline in CASA in the last one year is our concern and we expect margins would remain under pressure during FY08 on this count.

Core fee income up 26% YoY

Strong growth in fee income was the highlight of 1QFY08. While trading profits declined by 90% YoY, fees, forex gains and lower losses on AFS to HTM transfer made up for the same.

BREAK UP OF OTHER INCOME

| | 1QFY08 | 1QFY07 | YOY GR. % |
|------------------------------|------------|--------------|-----------|
| Core fee income | 1,058 | 842 | 26 |
| Treasury Profits | 135 | 1,345 | -90 |
| Forex income | 267 | 203 | 32 |
| Ammortisation on HTM | (620) | (500) | 24 |
| Recovery from w/off accounts | 140 | 90 | 56 |
| Transfer loss on investments | (330) | (2,350) | -86 |
| Other income | (34) | 28 | -222 |
| Total Other income | 616 | (342) | |

Source: Company/Motilal Oswal Securities

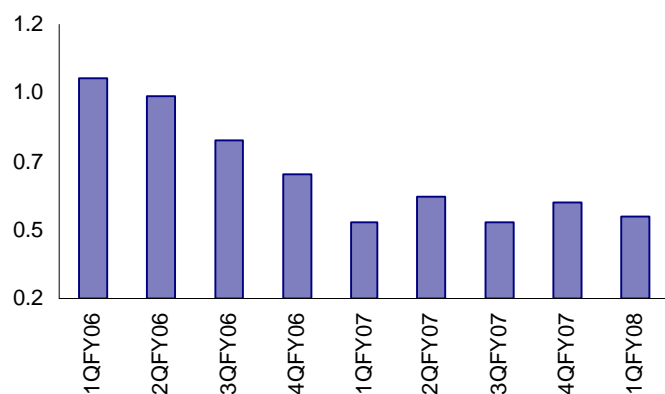
Management has guided for higher treasury profits during 2QFY08 and fee income growth to remain strong going forward.

Management transferred securities of Rs16b-17b from AFS to HTM during 1QFY08, taking a hit of Rs330m. Post this transfer the AFS portfolio occupies 30% of the total investment portfolio for the bank.

Asset quality remains robust – net NPA at 0.5%

Asset quality remained robust despite the faster asset growth. Gross NPAs declined by 80bp YoY to 2.3% (stable QoQ). Net NPAs remained stable YoY at 0.5% while it increased QoQ by 5bp. In absolute amount, while gross NPA increased by 1% QoQ, net NPAs decreased by 8% QoQ. Provision coverage remains high at 79%.

TREND IN NET NPAS (%)



Source: Company/Motilal Oswal Securities

Valuation and view

Over the last several quarters, IOB has been the most consistent state-owned bank on various operating parameters. The bank has also managed its bond portfolio and asset quality relatively better than other banks. Its RoE of ~25%+ is one of the highest in the sector. We expect earnings growth to remain strong. The stock trades at 4.8x FY09E EPS and 1.1x FY09E BV. We place IOB as one of our top picks in the sector and believe it can command premium valuations over other banks. Reiterate **Buy**.

NPA TREND (RS M)

| | 1QFY06 | 2QFY06 | 3QFY06 | 4QFY06 | 1QFY07 | 2QFY07 | 3QFY07 | 4QFY07 | 1QFY08 |
|-------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Gross NPA | 13,900 | 14,230 | 14,060 | 12,276 | 11,878 | 12,192 | 11,220 | 11,202 | 11,368 |
| Gross NPA % | 5.1 | 4.9 | 4.4 | 3.4 | 3.1 | 3.0 | 2.5 | 2.3 | 2.3 |
| Net NPAs | 2,729 | 2,650 | 2,377 | 2,243 | 1,768 | 2,296 | 2,070 | 2,578 | 2,364 |
| Net NPA % | 1.0 | 0.9 | 0.8 | 0.7 | 0.5 | 0.6 | 0.5 | 0.6 | 0.5 |

Source: Company/Motilal Oswal Securities

Indian Overseas Bank: an investment profile

Company description

Indian Overseas Bank (IOB), with a balance-sheet size of over Rs750b+, ranks amongst the 10 largest banks in India. Predominantly spread in the southern region of India, the bank has a network of over ~1,800 branches and 5 overseas branches. After the bank introduced IPOs in 2000 and 2003, the government's stake has reduced to 61.2%.

Key investment arguments

- ☞ Consistent improvement in all performance parameters for last several quarters. Hallmark is consistency in performance
- ☞ Has one of the best margins in the industry and has maintained high margins for over six quarters
- ☞ We expect the bank to maintain high RoAs and RoEs of 1.3% and ~26-27% for FY08 and FY09.

Key investment risks

- ☞ CASA has declined sharply in last one year. We believe margins would remain under pressure as cost of funds maintains upward trend
- ☞ High treasury profits increase the volatility of earnings.

COMPARATIVE VALUATIONS

| | | IOB | ANDHRA BK | VIJAYA BK |
|-----------|-------|------|-----------|-----------|
| P/E (x) | FY08E | 5.7 | 6.6 | 6.4 |
| | FY09E | 4.8 | 5.6 | 5.2 |
| P/ABV (x) | FY08E | 1.5 | 1.2 | 1.6 |
| | FY09E | 1.2 | 1.0 | 1.3 |
| RoE (%) | FY08E | 26.8 | 18.4 | 25.2 |
| | FY09E | 25.9 | 19.3 | 25.6 |
| RoA (%) | FY08E | 1.3 | 1.2 | 1.6 |
| | FY09E | 1.3 | 1.2 | 1.7 |

SHAREHOLDING PATTERN (%)

| | JUN-07 | MAR-07 | JUN-06 |
|---------------|--------|--------|--------|
| Promoter | 61.2 | 61.2 | 61.2 |
| Domestic Inst | 5.8 | 5.6 | 4.2 |
| Foreign | 18.2 | 18.0 | 17.7 |
| Others | 14.8 | 15.2 | 16.9 |

Recent developments

- ☞ IOB in joint venture with four other parties including Allahabad Bank and Karnataka Bank would float a general insurance company
- ☞ IOB has taken over Bharat Overseas Bank (erstwhile associate of the bank) adding ~100 branches to its network and a presence in Thailand. The acquisition price paid by IOB is reasonable in our view.

Valuation and view

- ☞ Consistent performance and improvement from the bank deserves a valuation premium
- ☞ Bank could be an active participant in the consolidation process
- ☞ Stock trades at P/E of 4.8x on FY09E EPS and P/BV of 1.1x on FY09E BV. We reiterate our **Buy** recommendation.

Sector view

- ☞ YTD loan growth of 24% and deposit growth of 24%
- ☞ Macro economic factors remain conducive for strong profitable growth for Indian banks
- ☞ Benefits of significant improvement in asset quality not yet factored in earnings, valuations
- ☞ We maintain an overweight stance on the sector.

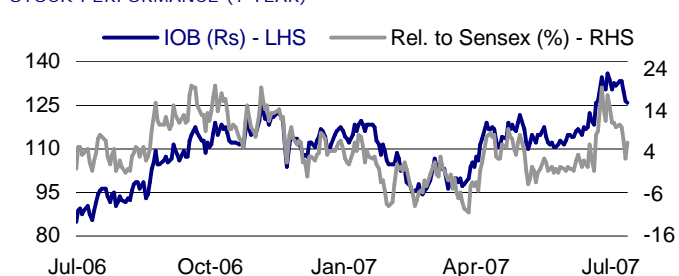
EPS: MOST FORECAST VS CONSENSUS (RS)

| | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| FY08 | 22.0 | 21.5 | 2.4 |
| FY09 | 26.4 | 25.3 | 4.4 |

TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 126 | 167 | 32.5 | Buy |

STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT | | (RS MILLION) | | | |
|----------------------------|---------------|---------------|---------------|---------------|--|
| Y/E MARCH | 2006A | 2007A | 2008E | 2009E | |
| Interest Income | 44,063 | 58,321 | 76,681 | 94,642 | |
| Interest Expended | 23,391 | 32,713 | 46,999 | 59,810 | |
| Net Interest Income | 20,672 | 25,608 | 29,683 | 34,832 | |
| Change (%) | 11.4 | 23.9 | 15.9 | 17.3 | |
| Other Income | 5,411 | 3,870 | 5,759 | 7,284 | |
| Net Income | 26,083 | 29,478 | 35,441 | 42,116 | |
| Change (%) | 4.5 | 13.0 | 20.2 | 18.8 | |
| Operating Expenses | 12,616 | 13,878 | 15,895 | 17,939 | |
| Operating Income | 13,467 | 15,600 | 19,546 | 24,176 | |
| Change (%) | 0.7 | 15.8 | 25.3 | 23.7 | |
| Other Provisions | 3,611 | 1,866 | 2,900 | 3,900 | |
| PBT | 9,856 | 13,734 | 16,646 | 20,276 | |
| Tax | 2,023 | 3,650 | 4,661 | 5,880 | |
| Tax Rate (%) | 20.5 | 26.6 | 28.0 | 29.0 | |
| PAT | 7,834 | 10,084 | 11,985 | 14,396 | |
| Change (%) | 20.3 | 28.7 | 18.8 | 20.1 | |
| Proposed Dividend | 1,416 | 1,634 | 1,907 | 2,179 | |

| BALANCE SHEET | | (RS MILLION) | | | |
|---------------------------|----------------|----------------|------------------|------------------|--|
| Y/E MARCH | 2006 | 2007 | 2008E | 2009E | |
| Capital | 5,448 | 5,448 | 5,448 | 5,448 | |
| Reserves & Surplus | 26,326 | 34,456 | 44,210 | 56,056 | |
| Net Worth | 31,774 | 39,904 | 49,658 | 61,504 | |
| Deposits | 505,293 | 687,404 | 852,381 | 1,022,857 | |
| Change (%) | 14.2 | 36.0 | 24.0 | 20.0 | |
| Borrowings | 7,366 | 28,962 | 36,203 | 45,254 | |
| Other Liabilities & Prov. | 49,144 | 66,298 | 76,243 | 83,867 | |
| Total Liabilities | 593,578 | 822,568 | 1,014,485 | 1,213,483 | |
| Current Assets | 37,072 | 89,793 | 109,672 | 127,329 | |
| Investments | 189,523 | 239,745 | 287,694 | 330,848 | |
| Change (%) | -0.3 | 26.5 | 20.0 | 15.0 | |
| Advances | 347,562 | 470,603 | 592,960 | 729,340 | |
| Change (%) | 37.9 | 35.4 | 26.0 | 23.0 | |
| Net Fixed Assets | 4,577 | 5,107 | 5,107 | 5,007 | |
| Other Assets | 14,843 | 17,321 | 19,053 | 20,959 | |
| Total Assets | 593,578 | 822,568 | 1,014,485 | 1,213,483 | |

| ASSUMPTIONS | (%) | | | |
|--------------------|------|------|------|------|
| Deposit Growth | 14.2 | 36.0 | 24.0 | 20.0 |
| Advances Growth | 37.9 | 35.4 | 26.0 | 23.0 |
| Investments Growth | -0.3 | 26.5 | 20.0 | 15.0 |
| Dividend | 26.0 | 30.0 | 35.0 | 40.0 |

E: MOST Estimates

| RATIOS | | 2006 | 2007 | 2008E | 2009E |
|-----------------------------|--|------|------|-------|-------|
| Spreads Analysis (%) | | | | | |
| Avg. Yield - Earning Assets | | 8.3 | 8.5 | 8.6 | 8.7 |
| Avg. Cost-Int. Bear. Liab. | | 4.9 | 5.3 | 5.9 | 6.1 |
| Interest Spread | | 3.4 | 3.2 | 2.8 | 2.6 |
| Net Interest Margin | | 3.9 | 3.7 | 3.3 | 3.2 |

| Profitability Ratios (%) | | 2006 | 2007 | 2008E | 2009E |
|---------------------------|--|------|------|-------|-------|
| RoE | | 27.2 | 28.1 | 26.8 | 25.9 |
| RoA | | 14 | 14 | 13 | 13 |
| Int. Expended/Int. Earned | | 53.1 | 56.1 | 61.3 | 63.2 |
| Other Inc./Net Income | | 20.7 | 13.1 | 16.2 | 17.3 |

| Efficiency Ratios (%) | | 2006 | 2007 | 2008E | 2009E |
|------------------------|--|------|------|-------|-------|
| Op. Exps./Net Income | | 48.4 | 47.1 | 44.8 | 42.6 |
| Empl. Cost/Op. Exps. | | 70.8 | 67.1 | 64.5 | 62.5 |
| Busi. per Empl. (Rs m) | | 32.0 | 42.0 | 52.1 | 64.2 |
| NP per Empl. (Rs lac) | | 3.2 | 4.2 | 4.8 | 5.8 |

| Asset-Liability Profile (%) | | 2006 | 2007 | 2008E | 2009E |
|-----------------------------|--|------|------|-------|-------|
| Adv./Deposit Ratio | | 68.8 | 68.5 | 69.6 | 71.3 |
| Invest./Deposit Ratio | | 37.5 | 34.9 | 33.8 | 32.3 |
| G-Sec/Invest. Ratio | | 81.9 | 86.2 | 86.2 | 89.9 |
| Gross NPAs to Adv. | | 3.4 | 2.3 | 2.1 | 2.1 |
| Net NPAs to Adv. | | 0.7 | 0.5 | 0.6 | 0.6 |
| CAR | | 13.0 | 13.3 | 12.0 | 11.7 |
| Tier 1 | | 8.5 | 8.2 | 7.5 | 7.2 |

| VALUATION | | 2006 | 2007 | 2008E | 2009E |
|--------------------|--|------|------|-------|-------|
| Book Value (Rs) | | 56.1 | 71.1 | 89.1 | 110.9 |
| Price-BV (x) | | 2.2 | 1.8 | 1.4 | 1.1 |
| Adjusted BV (Rs) | | 53.4 | 68.0 | 85.1 | 106.1 |
| Price-ABV (x) | | 2.4 | 1.8 | 1.5 | 1.2 |
| EPS (Rs) | | 14.4 | 18.5 | 22.0 | 26.4 |
| EPS Growth (%) | | 20.3 | 28.7 | 18.8 | 20.1 |
| Price-Earnings (x) | | 8.7 | 6.8 | 5.7 | 4.8 |
| OPS (Rs) | | 24.7 | 28.6 | 35.9 | 44.4 |
| OPS Growth (%) | | 0.7 | 15.8 | 25.3 | 23.7 |
| Price-OP (x) | | 5.1 | 4.4 | 3.5 | 2.8 |

E: MOST Estimates



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Indian Overseas Bank

- | | |
|---|-----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with Company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.