

## RESULT UPDATE

## Indian Overseas Bank

Maintain BUY

Price: Rs. 106

BSE Index: 13928

24<sup>th</sup> April 2007

### Share Data

Reuters code	IOBK.BO
Bloomberg code	IOB IN
Market cap. (US\$ mn)	1,382
6m avg. daily turnover (US\$ mn)	1.1
Issued Shares (mn)	545

Performance (%)	1m	3m	12m
Absolute	2	(5)	6
Relative	(3)	(5)	(9)

### Valuation Ratios

Year to 31 Mar.	2008E	2009E
EPS (Rs.)	22.3	24.5
+/- (%)	20.5	9.9
ABV (Rs.)	90.2	111.3
+/- (%)	27.8	23.4
PER (x)	4.8	4.3
PBV (x)	1.2	1.0
Dividend/Yield (%)	3.3	3.7

### Major shareholders (%)

Promoters	61
FII's	18
MF's	1
Institutions	3
Public & Others	17

### Financial highlights

(Rs. mn)	4QFY06	4QFY07	YoY (%)	FY06	FY07	YoY (%)	FY08E	YoY (%)	FY09E	YoY (%)
Interest earned	11,618	17,454	50.2	44,063	58,321	32.4	70,303	20.5	83,572	18.9
Interest expended	6,207	9,771	57.4	23,391	32,713	39.9	40,380	23.4	49,472	22.5
<b>Net Interest Income</b>	<b>5,411</b>	<b>7,682</b>	<b>42.0</b>	<b>20,672</b>	<b>25,608</b>	<b>23.9</b>	<b>29,923</b>	<b>16.9</b>	<b>34,100</b>	<b>14.0</b>
Other income	2,123	1,905	(10.3)	7,282	3,870	(46.8)	8,763	126.4	9,463	8.0
<b>Total Income</b>	<b>13,740</b>	<b>19,358</b>	<b>40.9</b>	<b>51,345</b>	<b>62,191</b>	<b>21.1</b>	<b>79,067</b>	<b>27.1</b>	<b>93,035</b>	<b>17.7</b>
Total Net Income	7,533	9,587	27.3	27,954	29,478	5.5	38,686	31.2	43,563	12.6
Staff expenses	2,256	2,423	7.4	8,936	9,311	4.2	10,154	9.1	11,052	8.8
Other operating expenses	1,168	1,547	32.5	3,680	4,567	24.1	4,793	4.9	5,261	9.8
<b>Operating Profits</b>	<b>4,110</b>	<b>5,617</b>	<b>36.7</b>	<b>15,338</b>	<b>15,600</b>	<b>1.7</b>	<b>23,739</b>	<b>52.2</b>	<b>27,250</b>	<b>14.8</b>
Provision & Contingencies	2,285	1,820	(20.4)	5,482	1,866	(66.0)	5,792	210.4	6,195	7.0
Provision for tax	(220)	900	-	2,023	3,650	80.4	5,384	47.5	6,948	29.1
<b>Reported Profits</b>	<b>2,045</b>	<b>2,898</b>	<b>41.7</b>	<b>7,834</b>	<b>10,084</b>	<b>28.7</b>	<b>12,563</b>	<b>24.6</b>	<b>14,107</b>	<b>12.3</b>

### 4QFY07 Results – BhOB merger boosts core business

**Indian Overseas Bank (hereinafter IOB) has reported a 41.7% y-o-y growth in net profit to Rs. 2.9 bn for 4QFY07. In FY07, the bank has posted a net profit of Rs. 10.1 bn, helped by Rs. 500 mn profit from BhOB operations. The bank has merged the operations of Bharat Overseas Bank (BhOB) with effect from 31<sup>st</sup> March 2007 as a result of which, the 4Q results reflect performance of the merged entity and hence not comparable with our estimates. The bank appears to have derived benefits from the merger, wherein it has shown a healthy business CAGR of 35.2% y-o-y to Rs. 1,167 bn. Net interest income also showed a robust 42% y-o-y growth to Rs. 7.7 bn on the back of improved NIMs at 4.16%, which is likely to have been helped by the deposit base of BhOB. The bank maintains a healthy Cost/Income ratio of 41.4%. Asset quality continues to be strong with the net NPA ratio at 0.55%, post the BhOB merger. The bank is well capitalised with a CAR ratio of 13.27%. We maintain our positive outlook on the stock and reiterate our BUY recommendation.**

### Highlights

- In 4QFY07, IOB has merged the operations of BhOB with itself; therefore, the reported performance is not comparable on a y-o-y basis. However, we believe the merger is value accretive as BhOB is a profitable well-run bank with domestic and international operations. For FY07, BhOB has added an estimated 5% to IOB's business and 7% to its branch network.
- In FY07, the combined business grew at a robust 35.2% y-o-y to Rs. 1,167 bn with the C-D ratio maintained at 69.7%. Going forward, the bank is expected to slowdown its business growth rates and focus on portfolio rebalancing. In the current fiscal, the bank plans to limit its exposure in the retail sector, including housing, consumer and personal loans, while focusing more on agriculture, SMEs and infrastructure segments.

Note: On account of BhOB merger, the FY07 figures have been reduced by Rs. 4 bn in other income as well as provisioning expenditure due to some accounting adjustments. There is no impact on the bottomline due to the same.

- On the deposit front, the CASA ratio has fallen from 40% in FY06 to current 36%. In the current fiscal, the bank is not expected to face deposit accumulation pressures due to lower business targets. Instead, IOB is focusing on increasing its CASA ratio to 42% in order to maintain margins at around 4% levels.
- Net interest income grew by 42% y-o-y to Rs. 7.7 bn, which led to a margin improvement of 10 bps y-o-y and 25 bps q-o-q to 4.16%. We believe the deposit base of erstwhile BhOB has partly helped the bank to post the margin improvement. Going forward, as the bank focuses on improving deposit structure and rebalancing credit portfolio away from high risk retail book, the current high NIMs are likely to come down to a more sustainable level of around 3.9% over the next two years.
- Fee-income generating businesses continued to grow well in 4QFY07. Of the total non-interest income, income from core banking operations increased by 35.4% y-o-y to Rs. 1 bn, while fee income from insurance, mutual fund products and merchant banking business grew by 153% to Rs. 775 mn. Operating profit grew by 37% y-o-y to Rs. 5.6 bn and net profit grew by 41.7% y-o-y to Rs. 2.9 bn.
- IOB has successfully absorbed the NPAs of the erstwhile BhOB (gross NPA of 3.21% and net NPA of 1.87%) along with improvements in asset quality over the last one year. The gross and net NPA ratios have improved by 109 bps and 10 bps to 2.34% and 0.55%, respectively. Even on capital adequacy front, IOB has been able to maintain a high CAR of 13.27%, post the merger. We believe this is a sufficient capital level to support its business growth needs as well as to comply with the Basel-II norms.
- The bank continues to maintain one of the best return ratios in the Indian banking sector. Post the merger, the RoA continues to be high at 1.4%. Going forward, we expect the bank to leverage the capital base of BhOB and its branch network, which will help IOB to sustain its high return ratios in the near future.
- For FY07, the bank has recommended a dividend of 30% amounting to Rs. 1.9 bn.

## Outlook

IOB has posted a healthy performance in the recent past with an increasing focus on core business along with focus on non-core income business. IOB expects to benefit from the recent acquisition of Bharat Overseas Bank. The bank expects to leverage the 102 local branch network and the Thailand operations of BhOB. The business and profit contributions from BhOB are also likely to improve from the current levels of 5%, thereby improving its return ratios. The fundamentals have also improved significantly backed by strong business growth, healthy margins, improved asset quality and comfortable capital adequacy ratio. Going forward, we expect the bank performance to improve as it now intends to capitalise on its strong balance sheet to catapult itself into the league of big banks. We maintain our positive outlook on the bank.

## Valuations

At the current market price of Rs. 106, the stock is trading at 4.8x FY08E and 4.3x FY09E earnings. On P/AB, the stock is trading at 1.2x FY08E and 1x FY09E adjusted book value. We reiterate our “BUY” rating on the stock.

## Bharat Overseas Bank merger

IOB has merged BhOB with itself effective 31st March 2007. We see the following benefits accruing to IOB from the merger:

- The merger is expected to add about 102 domestic branches and a full-fledged profitable branch in Bangkok to IOB's existing 1,544 branches. BhOB's branches will likely give IOB access to newer regions to grow.
- We believe the bank will be able to use the capital base of BhOB and leverage it more fruitfully using its experience.
- BhOB is a financially sound and profitable bank. The merger has added about 5% to IOB's business and profits, while having only a minimal impact on IOB's capital adequacy. We expect the contribution from BhOB branches to increase going forward.
- The Bangkok operations of BhOB will give IOB an opportunity to penetrate the Thai financial market, garner NRI remittance business and service the Indian corporate clientele operating in Thailand.

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**Analyst Certification**

We, Praveen Agarwal & Tejas Mehta, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

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