

Indian Overseas Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 11,835	IOB IN
	REUTERS CODE
S&P CNX: 3,508	IOBK.BO

27 April 2006

Buy
Previous Recommendation: Buy
Rs98

Equity Shares (m)	544.8
52-Week Range	133/67
1,6,12 Rel.Perf.(%)	-4/-44/-61
M.Cap. (Rs b)	53.6
M.Cap. (US\$ b)	1.2

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)
3/06A	27,954	7,833	14.4	20.3	6.8	1.7	13.0	27.0	1.4	1.9
3/07E	30,145	8,987	16.5	14.7	6.0	1.4	12.5	25.1	1.4	1.5
3/08E	33,594	10,601	19.5	18.0	5.1	1.1	12.0	24.1	1.5	1.2

Indian Overseas Bank (IOB) reported an earnings growth of 30% to Rs2.04b in 4QFY06. This robust growth was a function of a 13% YoY NII growth, coupled with strong growth in other income. Other income was propelled by higher fee income, strong treasury income and cash recoveries from written-off accounts. Asset quality has improved significantly, with net NPAs declining to 0.65% as of March 2006 from 1.27% as of March 2005. For FY06, NII grew by 11%, while earnings grew by 20%.

- ✍ Net interest income grows by 13%
- ✍ Margins continue to be strong; yield on advances improves
- ✍ Lower treasury income; growing fee income
- ✍ Net NPAs decline further to 0.65%

IOB has maintained its consistency in core earnings growth, backed by steady growth in its advances portfolio and improving NIMs. It has continued to impress by maintaining profit growth, despite cleaning up of its balance sheet and improving in its asset quality. We expect earnings to grow by 15% in FY07 and by 18% in FY08. The stock trades at 6x FY07E EPS and 1.4x FY07E BV and offers a yield of >2.5%. We expect the bank to deliver an RoE of >24% for FY07 and FY08. We reiterate **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Interest Income	9,707	9,823	10,068	9,913	10,254	10,758	11,433	11,618	39,510	44,063
Interest Expense	5,336	5,170	5,321	5,128	5,423	5,585	6,177	6,207	20,955	23,391
Net Interest Income	4,371	4,653	4,747	4,785	4,831	5,173	5,256	5,411	18,555	20,672
% Change (Y-o-Y)	19.6	20.2	13.8	11.2	10.5	11.2	10.7	13.1	16.0	11.4
Other Income	2,329	2,010	1,662	656	1,814	1,746	1,600	2,122	6,398	7,282
Net Income	6,700	6,662	6,409	5,441	6,646	6,919	6,856	7,533	24,953	27,954
% Change (Y-o-Y)	32.5	12.4	6.8	-15.2	-0.8	3.8	7.0	38.5	6.6	12.0
Operating Expenses	3,177	2,650	2,879	2,879	2,913	3,085	3,194	3,424	11,585	12,616
Operating Profit	3,523	4,012	3,530	2,562	3,732	3,834	3,663	4,110	13,368	15,338
Other Provisions	875	1,606	1,038	238	1,415	912	869	2,285	3,498	5,482
Tax Provisions	902	822	880	752	485	937	821	-220	3,356	2,023
Net Profit	1,746	1,583	1,612	1,572	1,832	1,985	1,972	2,044	6,514	7,834
% Change (Y-o-Y)	25.8	2.4	13.5	103.3	4.9	25.4	22.3	30.0	27.0	20.3
Cost to Income Ratio (%)	47.4	39.8	44.9	52.9	43.8	44.6	46.6	45.4	46.4	45.1
Interest Expense/Interest Income (%)	55.0	52.6	52.9	51.7	52.9	51.9	54.0	53.4	53.0	53.1
Other Income/Net Income (%)	34.8	30.2	25.9	12.1	27.3	25.2	23.3	28.2	25.6	26.1

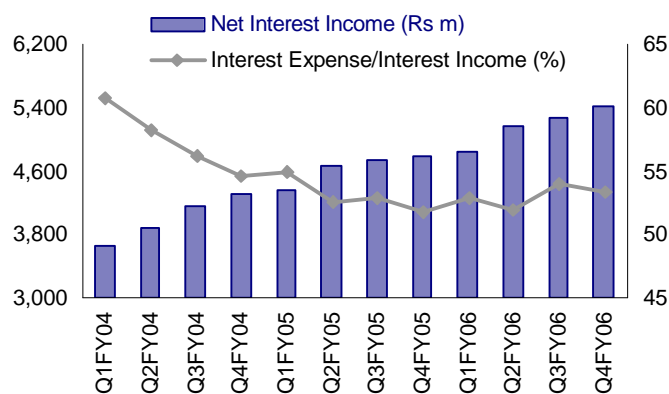
E: MSt Estimates * Qtlly nos might not tally with full years nos, as the bank has restated earlier nos.

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Net interest income grows by 13% YoY

IOB has grown its NII by 13% in 4QFY06 to Rs5.41b. This growth was achieved on the back of the bank's strategy to grow its loan book through incremental CASA deposits. While loans have grown by 36% YoY to Rs358b, deposits have grown by 14% to Rs505b. However, the low cost CASA deposits have grown by 17% YoY. As a result, the proportion of CASA has increased to 39.9% as against 38% in 4QFY05.

TREND IN NII



Source: Company/ Motilal Oswal Securities

Margins continue to be strong; yield on advances improves

Continuous deposit re-pricing, higher proportion of low-cost deposits and improving asset yields resulted in NIMs of 4.05% in FY06 versus 4.02% in FY05. While deposit cost has fallen by 5bp YoY to 4.7% in FY06, yields on advances have firmed up by 9bp to 8.81% in FY06. Investment yields have declined by 30bp to 8.5% in FY06.

MOVEMENT OF YIELDS (%)

	MAR-05	MAR-06
Yield on Advances	8.72	8.81
Yield on Investments	8.80	8.50
Cost of Deposits	4.74	4.69
Interest Spreads	4.02	4.05

Source: Company/ Motilal Oswal Securities

The NIMs earned by the bank are one of the best in the sector and IOB has been able to manage these 4% plus margins over the last six quarters. However, going forward, we believe that investment yields will tend to decline and could result in margin pressure. However, rising advances yield will provide some cushion. Overall, in our expectations, we are factoring in declining margins for the next couple of fiscals.

Lower treasury income; growing fee income

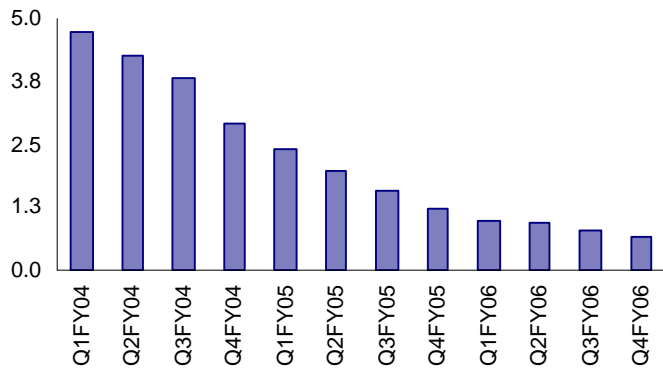
Even as treasury income has declined YoY from Rs3.22b to Rs2.34b in FY06 (treasury gains of Rs451m in 4QFY06), we believe that this is commendable, especially in a rising rate scenario. The bank's fee income has risen by 16% in FY06, driven by new products being marketed by the bank – mutual funds, insurance products, etc.

The bank has changed the way of reporting amortization expenses. Earlier, it used to net it off against treasury gains, but from 3QFY06, the bank has started reporting it under the provisioning head.

Net NPAs decline further to 0.65%

The bank has achieved a significant stride in improving its asset quality over the last 10 quarters. Net NPAs have dropped by 62bp YoY to 0.65%. Gross NPAs have also declined YoY by 185bp to 3.43%. IOB has made a cash recovery of Rs3.5b during FY06, against Rs2.6b during FY05. With increase in loan portfolio and aggressive cash recoveries, we expect the net NPAs to decline to 0.5% by the end of FY07.

TREND IN NET NPAS (%)



Source: Company/Motilal Oswal Securities

Investment book – HTM is 50%

As at end-FY06, approximately 50% of the bank's investment book of Rs188b lay in the HTM category. The total modified duration of the portfolio is 4.2 years. The

bank has no cushion left on the AFS book and a 1bp rise in 10-year G-sec yield from current levels will result in the bank taking a hit of approximately Rs20m. In 4QFY06, the bank has taken a provision for depreciation of Rs1.42b. We expect the bank to transfer securities to HTM during 1QFY07, thereby increasing the HTM portfolio.

Valuation and view

IOB has maintained its consistency in core earnings growth, backed by steady growth in its advances portfolio and improving NIMs. It has continued to impress by maintaining profit growth, despite cleaning up of its balance sheet and improving in its asset quality. We expect earnings to grow by 15% in FY07 and by 18% in FY08. The stock trades at 6x FY07E EPS and 1.4x FY07E BV and offers a yield of >2.5%. We expect the bank to deliver an RoE of >24% for FY07 and FY08. We reiterate **Buy**.

Indian Overseas Bank: an investment profile

Company description

Indian Overseas Bank (IOB), with a balance-sheet size of Rs583b, ranks amongst the 10 largest banks in India. Predominantly spread in the southern parts of India, the bank has a network of 1,496 branches (out of which 52 are specialized), 252 extension counters in India and 5 overseas branches. After the bank came out with IPOs in 2000 and 2003, the stake of the government has reduced to 61.2%.

Key investment arguments

- Consistent growth in core earnings for last several quarters.
- Net NPAs falling despite low provisioning.

Key investment risks

- Investments yields are still at 8.5%, which are likely to decline in future, resulting in margin pressure.

Recent developments

- IOB has raised Rs2b through an issue of 'perpetual bonds,' the first bank to use this means of funding. These bonds carry an interest rate of 9.3%.

Valuation and view

- Aggressive loan growth and margin expansion will drive core earnings growth.
- The bank could be an active participant in the consolidation process.
- The stock trades at P/E of 6x and P/BV of 1.4x FY07E; we maintain **Buy**.

Sector view

- Loan growth of 30% in FY06; likely to remain strong in FY07.
- Volatility in interest rates would impact treasury income.
- Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- We maintain an overweight stance on the sector.

COMPARATIVE VALUATIONS

		IOB	ANDHRA BK	VIJAYA BK
PE (x)	FY07E	6.0	6.8	5.9
	FY08E	5.1	5.7	4.6
P/ABV (x)	FY07E	1.5	1.2	1.2
	FY08E	1.2	1.0	1.0
RoE (%)	FY07E	25.1	18.1	21.2
	FY08E	24.1	19.0	23.5
RoA (%)	FY07E	1.4	1.3	1.0
	FY08E	1.5	1.4	1.1

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	25.0	25.0	22.0
Domestic Institutions	22.2	23.6	19.5
FII's/FDIs	36.5	34.5	40.0
Others	16.3	16.9	18.5

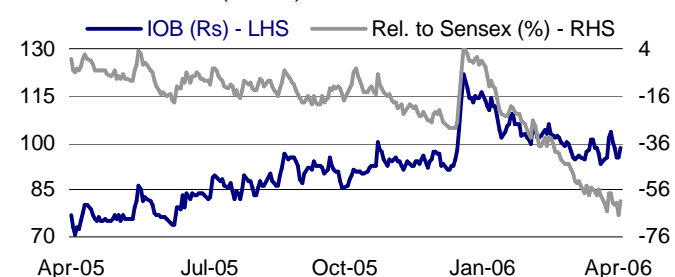
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	16.5	17.1	-3.5
FY08	19.5	20.2	-3.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
98	139	41.8	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	37,541	39,510	44,063	50,871	58,824
Interest Expended	21,547	20,955	23,391	27,713	32,486
Net Interest Income	15,994	18,555	20,672	23,158	26,338
Change (%)	30.9	16.0	11.4	12.0	13.7
Other Income	7,407	6,398	7,282	6,987	7,256
Net Income	23,401	24,953	27,954	30,145	33,594
Change (%)	34.4	6.6	2.0	7.8	11.4
Operating Expenses	10,149	11,585	12,616	13,789	15,070
Operating Income	13,252	13,368	15,338	16,357	18,524
Change (%)	66.9	0.9	14.7	6.6	13.3
Other Provisions	5,334	3,498	5,482	3,875	3,800
PBT	7,918	9,870	9,856	12,482	14,724
Tax	2,790	3,356	2,023	3,495	4,123
Tax Rate (%)	35.2	34.0	20.5	28.0	28.0
PAT	5,128	6,514	7,833	8,987	10,601
Change (%)	23.2	27.0	20.3	14.7	18.0
Proposed Dividend	1,229	1,484	1,416	1,634	1,634

BALANCE SHEET (RS MILLION)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Capital	5,448	5,448	5,448	5,448	5,448
Reserves & Surplus	15,363	20,304	26,720	34,073	43,040
Net Worth	20,811	25,752	32,168	39,521	48,488
Deposits	414,826	442,412	505,293	581,087	668,250
Change (%)	13.0	6.7	14.2	15.0	15.0
Borrowings	7,295	5,907	8,269	9,923	10,916
Other Liabilities & Prov.	30,289	34,079	35,783	37,572	39,451
Total Liabilities	473,220	508,150	581,514	668,104	767,105
Current Assets	52,451	49,540	29,832	23,045	16,302
Investments	201,716	190,147	187,770	210,302	231,333
Change (%)	8.4	-5.7	-1.3	12.0	10.0
Advances	202,949	252,052	345,311	414,373	497,248
Change (%)	16.3	24.2	37.0	20.0	20.0
Net Fixed Assets	4,040	4,523	5,523	5,998	6,398
Other Assets	12,064	11,888	13,077	14,385	15,823
Total Assets	473,220	508,150	581,514	668,104	767,105

ASSUMPTIONS (%)

Deposit Growth	13.0	6.7	14.2	15.0	15.0
Advances Growth	16.3	24.2	37.0	20.0	20.0
Investments Growth	8.4	-5.7	-1.3	12.0	10.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	20.0	24.0	26.0	30.0	30.0
GRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS

Y/E MARCH	2004	2005	2006E	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Asset	8.9	8.4	8.2	8.0	8.0
Avg. Cost-Int. Bear. Liab	5.4	4.8	4.9	5.0	5.1
Interest Spread	3.4	3.6	3.4	3.0	2.9
Net Interest Margin	3.8	3.9	3.9	3.7	3.6

Profitability Ratios (%)

RoE	29.0	28.0	27.0	25.1	24.1
RoA	12	13	14	14	15
Int. Expended/Int. Earned	57.4	53.0	53.1	54.5	55.2
Other Inc./Net Income	317	25.6	26.1	23.2	21.6

Efficiency Ratios (%)

Op. Exps./Net Income	43.4	46.4	45.1	45.7	44.9
Empl. Cost/Op. Exps.	74.2	72.8	70.8	66.8	66.5
Busi. per Empl. (Rs m)	23.3	26.9	32.2	38.7	45.3
NP per Empl. (Rs lac)	2.1	2.7	3.3	3.8	4.4

Asset-Liability Profile (%)

Adv./Deposit Ratio	48.9	57.0	68.3	71.3	74.4
Invest./Deposit Ratio	48.6	43.0	37.2	36.2	34.6
G-Sec/Invest. Ratio	83.6	82.7	87.9	87.9	87.1
Gross NPAs to Adv.	7.4	5.3	3.4	3.7	3.3
Net NPAs to Adv.	2.9	1.3	0.7	0.9	0.8
CAR	12.2	14.2	13.0	12.5	12.0
Tier 1	5.4	7.1	8.5	6.6	6.5

VALUATION

Book Value (Rs)	35.4	44.7	56.3	69.8	86.2
Price-BV (x)	2.8	2.2	1.7	1.4	1.1
Adjusted BV (Rs)	28.5	40.9	52.2	65.2	81.7
Price-ABV (x)	3.4	2.4	1.9	1.5	1.2
EPS (Rs)	9.4	12.0	14.4	16.5	19.5
EPS Growth (%)	0.6	27.0	20.3	14.7	18.0
Price-Earnings (x)	10.4	8.2	6.8	6.0	5.1
OPS (Rs)	24.3	24.5	28.2	30.0	34.0
OPS Growth (%)	36.2	0.9	14.7	6.6	13.3
Price-OP (x)	4.0	4.0	3.5	3.3	2.9

E: MOST Estimates



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

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

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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
MOST is not engaged in providing investment-banking services.	

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