Press Release

UCO Bank

April 18, 2019

Rating Assigned

Total facilities Rated	**Rs.500.00 Cr.**
Long Term Rating	ACUITE AA-/Stable

* Refer Annexure for details

Rating Rationale

Acuité has assigned its long-term rating of '**ACUITE AA-' (read as ACUITE double A minus)** to the Rs.500.00 Cr. Proposed Non-Convertible Basel III Compliant Tier-2 Bonds of UCO Bank. The outlook is **'Stable'**.

About UCO Bank:

Kolkata based, UCO Bank was founded in 1943 by the industrialist Mr. G. D. Birla as United Commercial Bank. The bank was nationalised in 1969 and renamed as UCO Bank in 1985. UCO Bank is a public sector bank which is engaged in retail banking, corporate/Wholesale banking, priority sector banking, treasury operations and other banking services. The bank operates through a network of 3086 branches in India and 2 branches, one each in Hong Kong and Singapore. The bank also has 2546 ATMs and 3600 Micro-ATMs as on December 31, 2018.

UCO Bank was listed on BSE and NSE in 2003 and Government of India holds 90.80 percent stake as on December 31, 2018.

Analytical Approach

Acuite has adopted a standalone approach to analyse the business and financial profile of UCO Bank. The ownership and the ongoing support from the Government of India is central to the rating.

Key Rating Drivers

Strengths

- **Government of India ownership with track record of support:**

UCO Bank, headquartered in Kolkata, is among the 14 banks nationalised in 1969. The Government of India (GoI) holds 90.8 percent stake in UCO Bank as on December 31, 2018 (84 percent as on March 31, 2018), which is one of its largest shareholdings in any public sector bank. The bank operates pan-India through a network of 3088 branches of which only 2 branches are overseas- one each in Hong Kong and Singapore. UCO bank has a strong regional franchise in Eastern and North Eastern India with 37 percent of the branches being located in these two regions. The bank plays a vital role in supporting the financial inclusion initiatives of the Government in these regions, some parts of which are remote without any alternative banking arrangements.

The GoI has been proactively supporting the Public sector Banks through regular infusion of funds in order to ensure their financial health, necessary for discharging their role as catalysts of economic growth and financial inclusion.

Over the past 4 years, 11 PSU banks (including UCO Bank) were placed within the purview of Prompt Corrective Action Framework (PCA) by RBI on account of the continued deterioration in their key operating metrics such as Capital Adequacy, Profitability and Asset Quality. UCO Bank was included in the PCA framework in May 2017. Government of India allocated Rs. 88,139 Cr. during FY2018 as a part of its recapitalisation initiative to strengthen the weakening capital position of these PSU banks. UCO Bank has already received Rs. 6,406 Cr. in FY2019 (by way of recapitalisation bonds). Besides the above infusion in the current year, Government has infused Rs. 9,367 Cr. in UCO Bank over the past 3 years. Such large quantum of capital infusion, one of the highest among public sector banks, reflects the strategic importance of UCO

Bank to GoI and the role it continues to play particularly in the economy of the eastern part of India.

The ongoing support from GoI has helped UCO Bank in maintaining its overall Capital Adequacy at 9.33 percent as on December 31, 2018 as against the required benchmark level 9.0 percent as per BASEL III norms. The tier-I equity capital stood at 7.14 percent as on December 2018, higher than the minimum of 7.0 percent required under the extant guidelines.

In addition to the regular capital infusion, UCO Bank's continuing focus on recoveries and resolution of the stressed assets in its books under the National Company Law Tribunal (NCLT) are expected to support the efforts of the bank to come out of the PCA framework by next financial year.

Acuite believes that GoI will continue to support UCO Bank in its revival path through further capital infusion, as and when required for adherence to the regulatory benchmarks. The continued ownership of GoI coupled with timing and magnitude of support will, nevertheless, be the key monitorables.

- **Healthy retail deposit franchise and exclusive trade account with Iran supports liability profile:**

UCO Bank has a pan India presence with around 37 percent of its branches (as on December 31, 2018) in the eastern and north eastern states, followed by 25 percent branches in north India and the balance distributed across Central, Western and Southern regions. UCO Bank has 60 percent of its branches in the rural and semi-urban regions which facilitates the mobilisation of small ticket deposits. On the strength of the extensive branch network, the retail deposits increased to Rs. 1.25 lakh Cr. as on March 31, 2018 (69 percent of overall deposits) as against Rs. 1.22 lakh Cr. as on March 31, 2017 (61 percent of overall deposits). The savings account amounted to Rs. 54,824 Cr. as on March 31, 2018 as against Rs. 51,537 Cr. as on March 31, 2017. The bank's overall deposits as on March 31, 2018 were Rs. 1.81 lakh Cr. (previous year- Rs. 2.01 lakh Cr.). The decline in aggregate deposits, however, was mainly on account of the bank's conscious strategy to shed bulk deposits. The top 20 depositors accounted to Rs. 15,580 Cr. (i.e. 8.57 percent) in FY2018 as against Rs. 24,890 Cr. (I.e.12.37 percent of overall deposits) in FY2017.

The bank has benefitted from a strong Current Account Saving Account (CASA) base which accounted for 37 percent of the total domestic deposits as on March 31, 2018 (previous year- 34 percent). This compares favourably with its peers among mid-sized public sector banks. Further, the increasing share of retail deposits in the overall deposit base reflects the strong retail franchise in its key operating regions. Since retail deposits are more stable than bulk deposits, the increasing contribution from the retail deposit segment augurs well from the standpoint of a stability in its deposits base.

In addition to the strong retail deposit platform, UCO Bank also benefits from being nominated for routing of trade transactions under 'Rupee Payment Mechanism' between India and Iran. In view of the US sanctions against Iran, India's imports of crude from Iran are required to be settled in Indian Rupees. As per this arrangement, the oil importing companies deposit their payments for crude oil imports in the Rupee Accounts maintained with UCO Bank. Similarly, any exporter from India to Iran will receive payments for the exports from these accounts. Since India's trade balances with Iran are usually in a deficit, UCO Bank stands to benefit considerably by way of large balances in these accounts which are profitably deployed in the various liquid investment options such as interbank markets, among others. These balances, however, are volatile depending on the magnitude of transactions with Iran. The balance as on March 31, 2018 was Rs. 1312 Cr. (previous year- Rs. 2426 Cr.); however, increased again to Rs. 2184 Cr. as on December 31, 2018 due to a significant rise in crude imports from Iran in the current year.

Acuite expects UCO Bank to benefit by way of lower cost of funds on the back of its stable retail deposit base and large current account balances accruing from the Iranian trade account.

Weakness:

- **Continuing weakness in asset quality, profitability and business levels:**

The deterioration in corporate sector credit quality over the period 2014-18 witnessed in the Indian banking sector has been significantly reflected through a high level of stress in UCO Bank's advances. Gross NPAs increased from Rs. 6,621 Cr. as on March 31, 2014 to Rs. 30,549 Cr. as on March 31, 2018, mainly on account of high levels of delinquencies in key sectors such as Power and Steel sector to which UCO Bank has a significant exposure. The GNPA ratio has increased sharply from 4.32 percent as on March 31, 2014 to 24.64 percent as on March 31, 2018 and further to 27.39 percent as on December 31, 2018. The NNPA, over the same period, increased from 2.38 percent to 13.10 percent over the period 2014-18 and slightly improved to 12.48 percent as on December 31, 2018. The top 20 NPAs of the bank comprised 35 percent of the total advances as on December 31, 2018.

UCO Bank's business (Deposits and Advances) has shown a decline from Rs. 3.52 lakh Cr. in FY2014 to Rs. 3.06 lakh Cr. in FY2018. The deposits have declined from Rs. 1.99 lakh Cr. to 1.82 lakh Cr. over the said period, whereas the advances have declined from Rs. 1.53 lakh Cr. to Rs. 1.24 lakh Cr partly due to the impact of the PCA framework.

The impact of the decline in advances coupled with the severe deterioration in asset quality has led to a significant erosion in the bank's profitability, reflected in higher operating expenses ratio and credit costs. The cost to Income ratio increased to 69 percent in FY2018 from 51 percent in FY2017. The provisions and write off increased to Rs. 5,771 Cr. in FY2018 from Rs. 4,777 Cr. In FY2017. The Return on Average Assets (ROAA), therefore, has been in the negative at 2.02 percent in FY2018 (0.79 percent in FY2017 and 1.15 percent in FY2016). In the current fiscal, profitability remained muted with ROAA in the negative at 1.35 percent (annualised) for the period April to December 2018 on account of higher credit cost of Rs. 4,849 Cr. The continued losses have resulted in erosion in the capital funds which has been partly offset by regular infusion of funds by the Government.

UCO Bank has intensified its recovery efforts by referring most of the large NPA accounts to NCLT. While some of them are at advanced stage of resolution, the timeframe and extent of haircut will be critical to UCO Bank's performance for FY2020. Despite the recoveries and upgradations during April to December, the incremental slippages of Rs. 7,450 Cr. for the said period have delayed any improvement in asset quality. The GNPA has marginally increased from Rs. 30,550 Cr. as on March 31, 2018 to Rs. 31,122 Cr. as on December 31, 2018.

While some of the PSU Bank have recently come out of PCA, UCO Bank continues to remain in the PCA framework mainly on account of continued weakness in its operating performance and key operating parameters. The turnaround in UCO bank's operating performance and its ability to exhibit an improvement in its asset quality and profitability parameters will be dependent on two variables- Firstly, a significant traction in its recoveries from the stressed accounts, which will help in reversing the high credit costs and Secondly, UCO Bank will also be required to demonstrate a pick-up in disbursements so as to ensure an increase in its loan book. The level of disbursements will be linked to credit off take in the economy and the bank's ability to identify the lending opportunities.

In the backdrop of a weak capital position constraining fresh lending along with delays in resolution of large stressed exposures, the possibility of a significant turnaround in the operating parameters appears less likely over the near term i.e. next 2-3 quarters. However, Acuité believes that the favourable stance of the Government as regards capital infusion and the regulator's approach regarding the attainment of the key operating metrics will be the key factors in UCO Bank's ability to come out of the PCA framework.

Liquidity Position

UCO Bank has adequate liquidity position as reflected in healthy Liquidity Coverage Ratio (LCR) of 266.7 percent as on December 31, 2018 as against regulatory requirement of minimum 100 percent. Besides maintaining CRR and SLR in excess of statutory requirements, the bank has also maintained liquid investments in non-SLR category which provide liquidity buffers.

Outlook: Stable

Acuite believes that UCO Bank will maintain a 'Stable' outlook on the back of continuing support from Government of India and its important position in the public sector banking system. The outlook may be revised to 'Positive' in case UCO Bank is able to demonstrate a significant and sustainable improvement in profitability, asset quality and capital adequacy. The outlook may be revised to 'Negative' In case the bank exhibits further deterioration in asset quality or profitability or lower than expected support from Government of India.

About the Rated Entity - Key Financials

Parameters	Unit	FY18 (Actual)	FY17 (Actual)	FY16 (Actual)
Interest Income	Rs. Cr.	14,020	16,326	18,561
Interest Expense	Rs. Cr.	10,895	12,509	13,713
Profit After Tax (PAT)	Rs. Cr.	(4,436)	(1,851)	(2,799)
Deposits	Rs. Cr.	1,81,849	2,01,285	2,07,118
Net Advances	Rs. Cr.	1,07,470	1,19,724	1,25,905
Investments	Rs. Cr.	70,962	74,019	83,974
Capital Adequacy	(%)	10.9	10.9	9.6
Return on Average Assets (RoAA)	(%)	(2.02)	(0.79)	(1.15)
Gross NPA	(%)	24.6	17.1	15.4
Net NPA	(%)	13.1	8.9	9.1

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Banks And Financial Institutions - https://www.acuite.in/view-rating-criteria-45.htm
- Default Recognition -https://www.acuite.in/view-rating-criteria-17.htm
- Financial Ratios And Adjustments - https://www.acuite.in/view-rating-criteria-20.htm

Note on complexity levels of the rated instrument

https://www.acuite.in/criteria-complexity-levels.htm

Rating History (Upto last three years)

Not applicable

***Annexure – Details of instruments rated**

ISIN	Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
-	Proposed Non-Convertible Basel III Compliant Tier-2 Bonds	-	-	-	500.00	ACUITE AA-/Stable (Assigned)

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About Acuité Ratings & Research:

Acuité Ratings & Research Limited (Erstwhile SMERA Ratings Limited) is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.