# UCO Bank

**May 25, 2018**

## Summary of Rated Instrument:

| Instrument | Rated Amount (Rs. crore) | Rating Outstanding |
|---|---|---|
| Lower Tier II Bonds – Basel II | 800.00 | [ICRA]A+ (Negative) |
| Upper Tier II Bonds – Basel II | 500.00 | [ICRA]A- (Negative) |

## Material Event

UCO Bank (UCO)[1] announced its Q4 FY2018 and FY2018 results. The bank reported a huge loss before tax of Rs. 2,127 crore and Rs. 4,427 crore during Q4 FY2018 and FY2018, respectively. However, the bank's capital ratios remain cushioned by capital infusion by the Government of India (GoI).

ICRA has a rating outstanding of [ICRA]A+ (pronounced ICRA A plus) for the Rs. 800-crore Lower Tier II bonds programme and [ICRA]A- (pronounced ICRA A minus) for the Rs. 500-crore Upper Tier II Bond programme of UCO Bank. The outlook on the long-term ratings is Negative.

## Update

Despite significant losses during Q4 FY2018 and FY2018, the bank was able to maintain capital ratios above the regulatory levels. This was mainly supported by the GoI's large capital infusion of Rs. 6,507 crore during FY2018 as well as the regulatory dispensations that were availed by the bank. The deferred provisions, on account of dispensations, stood at Rs. 942 crore (0.89% of risk-weighted assets - RWAs) as on March 31, 2018. These dispensations pertain to lower provisioning on National Company Law Tribunal (NCLT) accounts, amortisation of mark-to-market (MTM) losses on the investment portfolio and deferment of gratuity liability. Further, during Q1 FY2019, the bank exercised the early call option under a regulatory event for Tier 1 bonds totalling Rs. 750 crore (0.71% of RWAs as on March 31, 2018). The reported capital ratios, i.e. CET-I, Tier I and capital adequacy ratio (CRAR) stood at 8.23%, 8.94% and 10.94%, respectively, as on March 31, 2018, reflecting a cushion of just 6 bps on Tier I and CRAR levels (including CCB of 1.875%). Further, after adjusting the regulatory dispensation and the recall of Tier I bonds, the bank is at risk of breaching Tier I and CRAR regulatory requirements of 7.00% and 9.00%, respectively, in the near term unless capital is raised immediately. Given the bank's weak asset quality with high net NPA (NNPA) and losses at the operating level (excluding treasury income/loss and provisions), ICRA expects that the bank will report a loss during FY2019. Accordingly, the bank will require capital in FY2019 to offset losses and improve the CCB back to the 2.5% level required as on March 31, 2019.

ICRA expects that the bank will require a large capital infusion of ~Rs. 5,300-5,800 crore (~159-174% of its market capitalisation), assuming a 5-10% decline in RWAs, during FY2019 to report a minimum Tier I capital ratio of 9.5% including CCB of 2.5%. In a scenario the bank does not maintain the CCB, the capital requirement will be lower at ~Rs.3,000 crore (~90% of its market capitalisation). Ability to maintain Tier 1 of 7.0% and, hence, CRAR of 9.0% is critical for servicing its debt capital instruments, while adhering to the covenants for these instruments[2].

The ratings continue to factor in the majority sovereign ownership by the GoI, its demonstrated support for capital infusion, and the bank's strong franchise, which translates into a healthy and stable deposits base.

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[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*
[2] *Such as Upper Tier II instruments issued under Basel II*

## Outlook: Negative

ICRA expects the bank's capital requirements to remain significant in FY2019 and will take appropriate rating action if the bank reports CRAR below the regulatory levels[3] or maintains CCB below regulatory levels on a consistent basis.

## Key rating drivers

## Credit strengths

**Majority sovereign ownership** - The GoI held an 84.23% equity in the bank, as on March 31, 2018. The GoI, which has demonstrated consistent capital support to the bank, infused Rs. 1,925 crore and Rs. 6,507 crore of equity capital during FY2017 and FY2018, respectively. A high GoI shareholding provides the bank with the ability to raise capital from market sources while maintaining a majority GoI shareholding. However, given the bank's weak operating and financial profile, its ability to raise capital from the market remains to be seen. In the absence of the same, the bank will remain significantly dependent on the GoI to meet regulatory capital ratios. ICRA expects that the GoI will provide capital to public sector banks (PSBs) including UCO Bank to meet regulatory capital ratios.

**Strong franchise resulting in stable deposit base** - The bank has a strong franchise with 3,104 branches, including two in Hong Kong and two in Singapore as on March 31, 2017. The bank is mainly focussed on rural and semi-urban segments, with around 61% of its branches being in these areas. This also supports the bank's low cost current account and savings account (CASA) deposits, which was at 32.6% of total deposits (35.2% of domestic deposits) as on December 31, 2017. The bank's total deposits declined by 9.7% YoY, as on March 31, 2018, driven by lower deposit mobilisation with RWA reduction targets to be met.

## Credit challenges

**Capital ratios remain weak with large capital requirement and high GoI dependence during FY2019** - UCO reported Tier I and CRAR of 8.94% and 10.94%, respectively, with the capital ratios remaining just above minimum regulatory Tier I and CRAR (including CCB) levels of 8.875% and 10.875%, respectively, as on March 31, 2018. The capital ratios were weak despite the GoI's capital infusion of Rs. 6,507 crore during FY2018. The bank's capital ratios, with a buffer of just 6 bps on Tier 1 and CRAR, would have been below the regulatory requirements, as on March 31, 2018, had it not availed forbearances deferring provisioning requirements during FY2018. The provisions deferred include a) the Reserve Bank of India's (RBI) dispensation on lower provisioning by Rs. 460 crore for NCLT accounts of 40% (instead of the minimum 50%), which will be required to be provided for in Q1 FY2019, b) amortisation of MTM losses on the investment portfolio of Rs. 315.8 crore, and c) deferment of gratuity liability of Rs. 166.1 crore post enhancement in gratuity limits. Had the total provisions of Rs. 942 crore not been deferred, losses would have been higher resulting in lower CET I and Tier I ratios by around 0.89% (based on RWAs as on March 31, 2018).

Further, in Q1 FY2019, the bank exercised the early call option for Tier 1 bonds of Rs. 750 crore (0.71% of RWAs as on March 31, 2018) under a regulatory event as the bank was placed under the RBI's prompt corrective action (PCA) framework. ICRA notes that with the limited cushion, reduction of Tier I capital due to the early recall of Tier I bonds and expected losses during FY2019, the bank is at risk of breaching the Tier I and CRAR regulatory requirement of 7.00% and 9.00%, respectively, excluding CCBs, unless capital is raised immediately. The bank's board has approved to raise Rs. 3,000 crore of equity capital to support its weak capital ratios.

[3] *Tier 1 of 7% or CRAR of 9%, excluding capital conservation buffer(CCB) required of 1.875% as on March 31, 2018 and 2.5% as on March 31, 2019*

ICRA expects that the bank will require large capital infusion of ~Rs. 5,300-5,800 crore (~159-174% of its market capitalisation), assuming a 5-10% decline in RWAs, during FY2019 to report a minimum Tier I capital ratio of 9.5% including CCB of 2.5%. In a scenario, the bank does not maintain the CCB, the capital requirement will be lower at ~Rs. ~Rs. 3,000 crore (~90% of its market capitalisation). ICRA will continue to monitor UCO's capital raising in FY2019 and will take appropriate rating action if the capital levels fall below the regulatory requirement.

**Weak asset quality to remain during FY2019** - The asset quality continues to deteriorate with gross NPAs (GNPAs) of 24.64% at the end of Q4 FY2018 (17.12% at the end of Q4 FY2017 and 20.64% at the end of Q3 FY2018), which remains above the PSBs average. The rise in the GNPA ratio was due to an increase in the absolute level of GNPAs to Rs. 30,550 crore as on March 31, 2018 from Rs. 22,541 crore as on March 31, 2017, coupled with a decline in gross advances. The provision coverage ratio stood at 53.90% (61.38% including technical write-offs or TWO) as on March 31, 2018 compared to 52.52% (61.17% including TWO) as on March 31, 2017. As a result of higher GNPAs, the net NPAs (NNPAs) increased to 13.10% as on March 31, 2018 (8.94% March 31, 2017). Further, rising asset quality stress resulted in a weak solvency profile as reflected by NNPAs/Net worth of 112% at the end of Q4 FY2018 (103% at the end of Q4 FY2017), weaker than the PSBs average.

**Weak earnings profile marked by three consecutive years of losses, with the same expected to continue in FY2019 mainly due to weak asset quality** - The bank's net interest income (NII) declined by 18.1% YoY to Rs. 3,125 crore during FY2018 mainly due to interest reversals because of fresh slippages and high non-earning assets. With the decline in NII being higher than the decline in operating expenses, the core operating profitability (excluding credit provisions and profits from treasury activities) has been weakening and is insufficient to absorb the high credit provisions.

UCO continued to report losses over the last three consecutive fiscal years with loss before tax of Rs. 4,427 crore during FY2018, Rs. 1,840 crore during FY2017 and Rs. 2,779 crore during FY2016. The bank's losses increased due to elevated provisioning of Rs. 5,761 crore during FY2018 compared to Rs. 4,766 crore during FY2017 on account of NPA ageing coupled with the RBI's February 2018 circular wherein the threshold for stress resolution was reduced to special mention account (SMA) status of the borrower, thereby leading to the early recognition of stress. Consequently, the provisions spiked to Rs. 2,239 crore during Q4 FY2018, which resulted in a huge loss before tax of Rs. 2,127 crore compared to loss before tax of Rs. 582 crore and Rs. 1,016 crore during Q4 FY2017 and Q3 FY2018, respectively. ICRA expects a similar trend during FY2019 wherein UCO's credit provisions will be higher than its operating profits, thereby resulting in net losses. However, the extent of recovery from the resolution of accounts under NCLT will be crucial for ascertaining the level of losses and capital required for FY2019.

**Risk of being placed in higher threshold under PCA framework** - During May 2017, the RBI included UCO under the PCA framework under threshold 1, given the bank's high net NPAs and negative return on assets. However, the bank reported NNPA of 13.1% as on March 31, 2018, which might result in the bank being placed under threshold 3 as per the RBI's guidelines. The bank has also received RWAs reduction target from the GoI and the RBI recently restricted certain banking activities related to lending and deposit-taking operations of PCA banks. Any such restriction on UCO will further hamper its recovery and capital-raising ability.

**The previous rating rationale is available on the following link: Click here**

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:**

ICRA Rating Methodology for Banks

## About the company:

UCO Bank was established in 1943 as United Commercial Bank and was nationalised in 1969. The bank was wholly owned by the GoI until September 2003, when an initial public offer resulted in the GoI's stake reducing to 75%. As on March 31, 2018, the GoI held 84.23% stake in the bank. As on March 31, 2017, the bank operated 3,104 branches, including two branches in Hong Kong and two in Singapore. The bank is focussed on rural and semi-urban segments, with around 61% of its branches being in these areas. The bank operated 2,779 ATMs as on March 31, 2017.

For FY2018, the bank reported a net loss of Rs. 4,436 crore on an asset base of Rs. 2,13,704 crore compared to a net loss of Rs. 1,851 crore on an asset base of Rs. 2,29,015 crore for FY2017. As on March 31, 2018, the bank's capital adequacy was 10.94% (Tier-1: 8.94%; both Basel III), while its gross and net NPAs stood at 24.64% and 13.10%, respectively.

## Key financial indicators (audited) - Standalone

| | FY2017 | FY2018 | Q4FY2017 | Q4FY2018 |
|---|---|---|---|---|
| Net interest income | 3,817 | 3,125 | 609 | 808 |
| Profit before tax | (1,840) | (4,427) | (582) | (2,127) |
| Profit after tax | (1,851) | (4,436) | (588) | (2,134) |
| Net advances | 1,19,724 | 1,07,470 | 1,19,724 | 1,07,470 |
| Total assets (excluding revaluation reserves) | 2,29,015 | 2,13,704 | 2,29,015 | 2,13,704 |
| | | | | |
| % CET 1 | 7.64% | 8.23% | 7.64% | 8.23% |
| % Tier 1 | 8.27% | 8.94% | 8.27% | 8.94% |
| % CRAR | 10.93% | 10.94% | 10.93% | 10.94% |
| | | | | |
| % Net interest margin / Average total assets | 1.62% | 1.41% | 1.05% | 1.52% |
| % Net profit / Average total assets | -0.78% | -2.00% | -1.01% | -4.01% |
| % Return on net worth | -17.98% | -38.52% | -22.86% | -72.46% |
| | | | | |
| % Gross NPAs | 17.12% | 24.64% | 17.12% | 24.64% |
| % Net NPAs | 8.94% | 13.10% | 8.94% | 13.10% |
| % Provision coverage excl. technical write offs | 61.17% | 61.38% | 61.17% | 61.38% |
| % Net NPA/ Net worth | 102.64% | 111.71% | 102.64% | 111.71% |

*Amounts in Rs. crore; Net worth excludes revaluation reserves*

*Source: UCO Bank; ICRA research*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years:

| Sl. No | Instrument | Current Rating (FY2019) Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. Crore) | Date & Rating in FY2019 | Chronology of Rating History for the past 3 years: Date & Rating in FY2018 | | Date & Rating in FY2017 | | | Date & Rating in FY2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | May 2018 | Aug 2017 | June 2017 | June 2016 | May 2016 | April 2016 | Feb 2016 |
| 1 | Lower Tier II Bonds | Long Term | 800.00 | 800.00 | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | [ICRA]A+ (Negative) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) | [ICRA]AA (Negative) | [ICRA]AA (Negative) |
| 2 | Upper Tier II Bonds | Long Term | 500.00 | 500.00 | [ICRA]A- (Negative) | [ICRA]A- (Negative) | [ICRA]A- (Negative) | [ICRA]A (Negative) | [ICRA]A+ (Negative) | [ICRA]AA- (Negative) | [ICRA]AA- (Negative) |

## Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

## Annexure-1: Instrument Details

| ISIN No | Instrument Name | Date of Issuance / Allotment | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| INE691A09169 | Lower Tier II Bonds | 08-Mar-2010 | 8.92% | 08-Mar-2020 | 800.00 | [ICRA]A+(Negative) |
| INE691A09177 | Upper Tier II Bond | 25-Mar-2010 | 8.90% | 25-Mar-2025 (Call:25-Mar-2020) | 500.00 | [ICRA]A-(Negative) |

*Source: UCO Bank; ICRA research*

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## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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