June 28, 2019

Union Bank of India: Short-term rating reaffirmed; long-term ratings withdrawn

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificates of Deposit	**15,000.00**	15,000.00	[ICRA]A1+; reaffirmed
Lower Tier II Bonds – Basel II	800.00	-	[ICRA]AA+(Stable); withdrawn
Basel II Compliant Innovative Perpetual Debt Instruments	200.00	-	[ICRA]AA(Stable); withdrawn
Total	**16,000**	**15,000**	

Rationale

The rating for Union Bank of India is supported by its majority sovereign ownership (Government of India – GoI shareholding of 74.27% as on March 31, 2019) and its position as a key public sector bank (PSB) with a 3.3% share in banking sector advances and 3.5% share in domestic bank deposits as on March 31, 2019. Moreover, given the relatively weak financial performance and deterioration in the bank's capitalisation position, the GoI infused Rs. 4,112 crore in Q4 FY2019, which helped shore up the capital position above the regulatory requirements. Union Bank also mobilised Rs. 568 crore under its employee share purchase scheme (ESPS), which aided its overall capital position.

The bank's asset quality remains weak with high fresh slippages of 5.1% of standard assets in FY2019 compared to 8.0% in FY2018. The gross non-performing assets (GNPAs) and net NPAs (NNPAs) stood at 14.98% and 6.85%, respectively, as on March 31, 2019 (15.73% and 8.42%, respectively, as on March 31, 2018). Accordingly, the credit provisions remained elevated at 2.34% of average total assets (ATA) in FY2019 compared to 2.89% in FY2018, thereby translating into a net loss with Net Loss/ATA of 0.60% in FY2019 compared to 1.12% in FY2018. The high level of NNPAs also translated into a weak solvency profile with NNPA/Net Worth of 83% as on March 31, 2019, despite the capital support in Q4 FY2019. Moving ahead, ICRA expects Union Bank to bring the NNPA levels below 6% as on March 31, 2020, which will make the possibility of the bank's inclusion in the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework unlikely.

Going forward, ICRA estimates the pace of fresh NPA generation to decline to ~2.3-3.0% in FY2020, which is likely to temper credit costs. The credit costs are expected to moderate to ~1.2-1.5% of ATA in FY2020. While this is likely to be absorbed through the bank's core operating profits, it will translate into weak internal capital generation with return on assets (RoA) of <0.2% in FY2020. Accordingly, in ICRA's view, the bank will need to raise equity capital to support growth, improve its provision coverage on NPAs, and meet the increasing regulatory requirements. As a step in this direction, Union Bank has approved an equity capital raise of up to Rs. 4,900 crore for FY2020, though the extent of capital requirement will remain linked to the recoveries in FY2020. ICRA expects Union Bank's capital requirement in FY2020 to remain sizeable at ~25-33% of its current market capitalisation.

Outlook: Not applicable

Key rating drivers

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The rating continues to factor in the bank's majority sovereign ownership (74.27% equity shares held by the GoI as on March 31, 2019) and demonstrated capital infusion from the parent (Rs. 4,524 crore in FY2018 and Rs. 4,112 crore in FY2019) to support the capitalisation position. Although losses in FY2019, due to the weak asset quality, led to capital erosion, the timely capital support from the GoI in Q4 FY2019 helped shore up the bank's capital position. Moreover, the bank raised Rs. 568 crore by way of an ESPS, which supported its capitalisation. The capital infusion and higher GoI stake as on March 31, 2019 has improved the bank's ability to raise capital from the market while maintaining a majority GoI shareholding, subject to investor appetite.

Well-developed deposit franchise – Union Bank has an extensive network of over 4,291 branches, of which ~59% are in the rural and semi-urban region, providing access to low cost savings and current account deposits (CASA) as on March 31, 2019. The bank had a satisfactory CASA base of 36.35% [1]as on March 31, 2019, though this was below the PSB average of ~39%. While the overall branch network remained stable, with the exception of a few branches that were closed to contain costs by rationalising relatively inefficient branches, CASA mobilisation continued to grow in FY2019 with the same at Rs. 1,50,141 crore compared to Rs. 1,39,241 crore as on March 31, 2018. Accordingly, the cost of interest-bearing funds declined to 5.23% in FY2019 from 5.37% in FY2018, although it remained above the PSB average.

Share of advances to RAM segment increases – The bank's gross advances grew by ~4% on a YoY basis to Rs. 3,25,392 crore as on March 31, 2019 from Rs. 3,13,860 crore as on March 31, 2018. While advances to the mid and large corporate segment grew by 6% in FY2019, the retail, agriculture and MSME (RAM) segment grew at a higher rate of ~9% to Rs. 1,73,237 crore as on March 31, 2019, from Rs. 1,58,642 crore as on March 31, 2018, mainly driven by the strong growth in retail loans. As a result, the share of advances to the RAM segment increased marginally to ~56% as on March 31, 2019 from 55% as on March 31, 2018. The increasing share of RAM in total advances will help make the loan book more granular over time. This is, however, offset by relatively weak asset quality, especially in the MSME segment, which is reflected in the advances of Rs. 2,637 crore under regulatory forbearance as on March 31, 2019, among the highest within the banking sector.

Credit challenges

Asset quality to remain weak despite slowdown in slippages – The overall stock of GNPAs remained high in FY2019 due to high slippages amounting to Rs. 13,577 crore. While the slippages were offset by recoveries, upgradations and write-offs (amounting to Rs. 14,218 crore), the bank's asset quality indicators remained weak with GNPAs of Rs. 48,729 crore (GNPA/Gross Advances at 14.98%) and NNPAs of Rs. 20,332 crore (NNPA/Net Advances at 6.85%) as on March 31, 2019. Moreover, a large stock of unprovided NPAs, coupled with weak capitalisation, kept the solvency indicators weak with NNPA/Net Worth at 83% as on March 31, 2019.

In addition to this, Union Bank has sizeable Special Mention Account-2 (SMA-2) exposures at ~3% of the standard advances as on March 31, 2019. As the bank continues to make efforts towards scaling up its RAM book, the volume of stressed assets in this segment has increased with the SMA-2 exposures in this segment estimated at 2% of retail advances. Given the high level of SMA-2 exposures in the RAM segment, the risk profile of the incremental credit remains under watch to determine the future asset quality of this segment. ICRA expects fresh NPA formation to slow down to ~2.3-3% of standard advances in FY2020 compared to the elevated level of ~5.1% in FY2019. This is likely to

1 Calculated as CASA/Total Domestic Deposits

contain the credit costs with the same expected to moderate to ~1.2-1.5% of assets in FY2020 from ~2.4% in FY2019. Moreover, to bring down the NNPA levels to less than 6%, Union Bank is expected to increase the overall provision coverage ratio to 70-72% in FY2020 from the level of 58.3%[2] as on March 31, 2019. While this will keep the bank dependent on capital support, efforts to contain the NNPA levels within 6% will make the possibility of being placed under the PCA framework unlikely.

Lower slippages expected to support profitability though return indicators to remain muted – The net interest margins, as a percentage of ATA, remained satisfactory at 2.09% in FY2019 (against the PSB average of 2.33%). However, the core profit before tax (PBT; after provisions) continued to be impacted by the high credit costs of ~2.4% for FY2019 on account of high slippages. As a result, core PBT/ATA remained weak at -0.91% in FY2019. Accordingly, Union Bank's pre-tax losses stood at Rs. 3,927 crore in FY2019 though this was lower compared to losses of Rs. 6,641 crore in FY2018. Going forward, ICRA expects slippages to be lower in FY2020 with fresh NPA generation rate to remain lower at ~2.3-3.0% of standard advances. Against this, the overall credit costs are likely to remain lower, which should support the overall profitability. While the overall internal capital generation is likely to witness improvement in FY2020, meaningful recoveries will also remain key in shoring up profitability. However, despite the improvement in the overall profitability, the overall return metrics are likely to remain muted with RoA estimated at <0.2% while the return on net worth is estimated to remain weak at 0.9-4% in FY2020.

Capital cushion remains thin – Union Bank reported a net loss of Rs. 2,948 crore in FY2019 compared to a net loss of Rs. 5,247 crore in FY2018. Capital erosion during the last two years led to a moderation in the bank's capitalisation profile. However, with the GoI extending support by infusing Rs. 4,112 crore in FY2019, the bank's capital ratios were restored to levels as on March 31, 2018. Union Bank's regulatory capital adequacy stood at 11.78% (Tier I of 9.48% and CET I of 8.02%) under Basel III norms as on March 31, 2019 against the minimum regulatory requirement of CRAR of 10.875%, Tier I of 8.875% and CET I of 7.375% as on March 31, 2019. Further, the capital ratios were supported by Rs. 568 crore raised under the bank's ESPS in Q4 FY2019. Despite these efforts, Union Bank's overall capital position remains weak in relation to the regulatory requirement of CRAR of 11.5%, Tier I of 9.5% and CET I of 8% as on March 31, 2020. Moreover, ICRA estimates that the overall capital requirement will remain sizeable in FY2020, with Tier I capital estimated at Rs. 3,000-4,400 crore, with growth in risk-weighted assets estimated between 7% and 9% on a YoY basis. Meanwhile, Union Bank has approved an equity capital raise of up to Rs. 4,900 crore for FY2020, though the extent of capital requirement will remain linked to recoveries which will also be instrumental in influencing investor appetite. ICRA estimates Union Bank's capital requirement in FY2020 to remain at ~25-33% of its current market capitalisation.

Liquidity position

The bank's daily average liquidity coverage ratio remained comfortable at 129% in FY2019 against the regulatory requirement of 100%. The statutory liquidity ratio (SLR) stood at 23% of the net demand and time liabilities as on March 31, 2019 and was above the regulatory requirement of 19%. ICRA expects Union Bank to maintain satisfactory liquidity, which will depend on its ability to retain its deposit base. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity needs.

2 Excluding Technical write off

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The rating factors in Union Bank's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support the bank with capital infusion, if required
Consolidation/Standalone	The rating is based on the standalone financial statements of Union Bank

About the company

Majority owned by the GoI (74.27% as on March 31, 2019), Union Bank of India is a large commercial bank in the country with an asset base of Rs. 4.92 lakh crore as on March 31, 2019. The bank has a network of 4,291 branches and 6,650 ATMs as on March 31, 2019. Union Bank reported a net interest income of Rs. 10,215 crore in FY2019 and a net loss of Rs. 2,948 crore vis-à-vis Rs. 9,305 crore and Rs. 5,247 crore, respectively, in FY2018. The bank's gross and net NPAs stood at elevated levels of 14.98% and 6.85%, respectively, as on March 31, 2019, though below 15.73% and 8.42%, respectively, as on March 31, 2018. The regulatory capital adequacy ratio under Basel III stood at 11.78% (Tier I – 9.48%, CET I – 8.02%) as on March 31, 2019.

Key financial indicators (standalone) – Union Bank of India

	FY2018	FY2019	Q4 FY2018	Q4 FY2019
Net interest income	9,305	10,215	2,193	2,602
Profit before tax	-6,641	-3,927	-3,779	-4,036
Profit after tax	-5,247	-2,948	-2,583	-3,369
Net advances	2,88,761	2,96,932	2,88,761	2,96,932
Total assets	4,85,064	4,92,066	4,85,064	4,92,066
% CET	7.56%	8.02%	7.56%	8.02%
% Tier 1	9.03%	9.48%	9.03%	9.48%
% CRAR	11.46%	11.78%	11.46%	11.78%
% Net interest margin / Average total assets	1.99%	2.09%	1.83%	2.16%
% Net profit / Average total assets	-1.12%	-0.60%	-2.16%	-2.79%
% Return on net worth	-23.77%	-12.47%	-46.97%	-56.52%
% Gross NPAs	15.73%	14.98%	15.73%	14.98%
% Net NPAs	8.42%	6.85%	8.42%	6.85%
% Provision coverage excl. technical write-offs	50.73%	58.27%	50.73%	58.27%
% Net NPA / Net worth	106.90%	82.94%	106.90%	82.94%

Amount in Rs. crore
Source: Union Bank of India, ICRA research
All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Sr. No.	Name of Instrument	Current Rating FY2020				Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. Crore)	Jun-19	FY2019		FY2017	FY2016
						May-18	Apr-18	Mar-17	Feb-16
1	Certificates of Deposit	Short Term	15,000.00	NA	[ICRA] A1+	[ICRA]A1+; assigned	[ICRA]A1+	[ICRA]A1+	NA
2	Lower Tier II Bonds – Basel II	Long Term	800	-	[ICRA]AA+ (stable); withdrawn	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)
3	Basel II Compliant Innovative Perpetual Debt Instruments	Long Term	200	-	[ICRA]AA (stable); withdrawn	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (stable)

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Certificates of Deposit	-	-	7-365 days	15,000.00	[ICRA]A1+
INE692A09167	Lower Tier II bonds	17-Sep-2008	10.95%	16-Sep-2018	400.00	[ICRA]AA+(stable); withdrawn
INE692A09175	Lower Tier II Bonds	23-Dec-2008	9.50%	22-Dec-2018	200.00	[ICRA]AA+(stable); withdrawn
INE692A09183	Lower Tier II Bonds	30-Dec-2008	8.60%	29-Dec-2018	200.00	[ICRA]AA+(stable); withdrawn
INE692A09159	Basel II Complaint Innovative Perpetual Debt Instrument	09-Sep-2008	11.15% (Step up to 11.65% after 10 years)	Perpetual (Call: 09-Sep-2018)	200.00	[ICRA]AA(stable); withdrawn

Source: Union Bank

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About ICRA Limited:

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