

## UCO Bank

Instrument	Amount	Rating	Rating Action
Lower Tier II Bonds	Rs. 800 crore	[ICRA]AA (Negative)	Re-affirmed; outlook revised to 'Negative' from 'Stable'
Lower Tier II Bonds	Rs. 275 crore	[ICRA]AA (Negative)	
Upper Tier II Bonds	Rs. 500 crore	[ICRA]AA- (Negative)	

ICRA has reaffirmed [ICRA]AA (pronounced ICRA double A) rating outstanding for Lower Tier II bonds programme aggregating to Rs 1,075 crore\* of UCO Bank (UCO)<sup>†</sup>. ICRA has also reaffirmed [ICRA]AA- (pronounced ICRA double A minus) rating for Rs. 500 crore Upper Tier II Bond programme of UCO. The outlook on the long term ratings of the bank has been revised to 'Negative' from 'Stable'.

The revision in outlook reflects significant continued pressure on earnings and solvency of UCO due to sharp deterioration in asset quality as well as limited visibility on capital availability to fully support credit growth while meeting regulatory minimum requirement.

The ratings continue to draw comfort from UCO bank's majority sovereign ownership (72.83% equity shares are held by Government of India or Gol as on December 31, 2015), bank's strong franchise imparting healthy and stable deposits base, and comfortable liquidity profile. However, UCO's low earnings remain a credit concern, further in light of low tier I capital; UCO's tier 1 capital requirements are large in relation to its market capitalisation at 140%-200%<sup>‡</sup>. Given the current stance of Gol on providing equity, UCO will have to mobilize significant equity / tier I from non government sources.

Sharp deterioration in asset quality is due to higher than anticipated stress, slower than expected pace of recovery and weak outlook for several credit intensive sectors.

Recognition of stress was reflected in Q3, FY16 asset quality indicators for UCO, when RBI post its 'asset quality review' directed banks to bring consistency in NPA recognition for stressed accounts. UCO's Gross NPA % increased from 8.51% as on September 2015 to 10.98% as on December 2015, and is expected to further worsen in Q4, FY16.

Higher than expected slippage in UCO's asset quality has led to significant dilution in earnings relation to the risk (UCO's annualized operating profits<sup>§</sup> in relation to net NPAs have dropped to 40%<sup>\*\*</sup> in Q3, FY16 vs. 50% in Q2, FY16).

UCO's exposure to stressed sectors (Iron & Steel and Power) is relatively high at around 23% of their loan book (as on Sep 2015) and its gross NPA plus restructured advances are relatively high at around 17%<sup>††</sup> (as on Dec 2015), which could lead to elevated fresh NPA generation rate and make recoveries more challenging over next 1-2 years.

Additionally, sizeable Net NPAs (6.51% as on December 31, 2015) and other weak assets (standard restructured advances of around 5.8% and some other weak standard assets) are likely to keep credit costs elevated over next 2-3 years, leading to pressure on earnings and therefore internal capital generation. Furthermore, requirement to increase provisioning cover for some restructured advances could elevate credit cost further in FY17.

\* 100 lakh = 1 crore = 10 million

† For complete rating scale and definitions please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

‡ During the period FY16 – FY19

§ Operating profit before credit provisions and profit on sale of investments

\*\* For Q3FY16, profit on sale of investments is not available and included in operating profit, hence the figure would be lower than reported

†† The figure for gross NPA plus restructured advances would be 15%, if restructured exposure of SEBs and Air India are excluded from restructured advances



UCO's core operating profitability<sup>##</sup> at 1.3% for 9MFY16 (declined by ~30 bps from FY15 with rising proportion of non-income accruing assets), is weak compared to its high credit cost (credit provisions in relation to ATA<sup>§§</sup> of around 1.9% in 9M, FY16) leading to losses at net level. The bank reported a net loss of Rs. 1,497 crs. during Q3FY16 (Rs. 1,084 crs. during 9M FY16).

The bank would also witness increase in its cost of deposits due to withdrawal of current deposits garnered by UCO as a sole agency for rupee settlement mechanism for oil imports from Iran (~50% of current account deposit). UCO's profitability is expected to remain under pressure over next 2-3 years as cost of deposits increase and credit cost is expected to remain at elevated levels.

UCO's Tier I capital and CRAR was 7.69% and 10.54% respectively as on December 31, 2015 as against regulatory minimum requirement of 7.625% and 9.625% respectively as on March 31, 2016<sup>\*\*\*</sup>.

This would lead to limited ability of the bank to grow its credit book. With further slippages expected during Q4FY16 leading to pressure on internal accruals, bank's ability to raise fresh capital and hence maintain the minimum regulatory capital would be a key rating sensitivity. Additionally, UCO's net NPAs in relation to net worth<sup>+++</sup> have increased to 77% as on December 2015 from 53% as on March 15, weakening the ability of the bank to withstand unexpected losses.

The bank would need to raise sizeable capital to meet increasing regulatory minimum requirements as well as for growth both in the near term (Mar-16) and over the period FY17-FY19.

If the bank reports similar losses during Q4FY16 (as witnessed during Q3FY16), the tier 1 capital of the bank (as on March 2016) would be lower than the minimum regulatory requirement. In ICRA's estimate, UCO would require to raise tier 1 capital of Rs. 16.8 – 17.6 billion during FY16 to meet the minimum regulatory requirement as on March 2016.

ICRA also estimates that UCO would be required to raise common equity capital of Rs. 25-41 billion and additional tier I capital (AT1) of Rs. 25-28 billion during FY16-FY19 to meet increase in regulatory minimum capital requirement as well as for growth. UCO's common equity requirement is equivalent to 70-120% of its current market capitalisation. In case of lack of adequate investor appetite for AT1 capital raising, the gap would need to be met through further core capital raising, thereby increasing core capital raising requirements further to 140%-200%. Ability to strengthen tier I capital and timely support from GoI would remain a key driver for UCO's credit profile.

### **Bank profile**

UCO Bank, established in 1943 as United Commercial Bank was nationalised in 1969. The bank was wholly owned by the Government of India until September 2003, when the bank's IPO reduced the Government stake to 75%. As on December 31, 2015, Government of India (GoI) held 72.83% equity shares of the bank. As on September 30, 2015 the bank had 3,037 branches, out of which two branches are in Hongkong and two are in Singapore; all the branches of the bank operate on core banking solution (CBS). The branch demographic profile has a skew in favour of rural and semi-urban segments, with around 60% of the bank's branches being in these segments. In addition, the bank had 2,096 ATMs as on March 31, 2015.

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<sup>##</sup> Operating profit before credit provisions and profit on sale of investments in relation to ATA, based on ICRA's calculations

<sup>§§</sup> Average Total Assets

<sup>\*\*\*</sup> Including capital conservation buffer of 0.625%

<sup>+++</sup> net of revaluation reserve and accumulated losses



For the financial year ended March 31, 2015 the bank reported a profit after tax (PAT) of Rs. 1,138 crore on an asset base<sup>†††</sup> of Rs. 2,45,307 crore as compared to a PAT of Rs. 1,511 crore on an asset base<sup>†††</sup> of Rs. 2,38,537 crore for the previous financial year. For 9MFY16 the bank reported a net loss of Rs. 1,084 crore against a net profit of Rs. 929 crore during the corresponding period in the previous financial year. As on Dec 31, 2015, the bank's capital adequacy was 10.54% (Tier-1: 7.69%; both Basel III), while its gross NPA was 10.98% and net NPA% was 6.51%.

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