UCO Bank

February 23, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier II Bonds[&]	500.00	CARE AA-; Stable	Reaffirmed

Details of instruments/facilities in Annexure-1.

[&]Tier-II Bonds under Basel III are characterised by a point of non-viability (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations, and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses, and raising the Common Equity Tier-I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable.

Rationale and key rating drivers

The reaffirmation of the ratings assigned to the Tier II Bonds of UCO Bank (UCO) continues to factor in the majority ownership and the demonstrated and expected continued support in terms of capital and management from Government of India (GOI). The ratings continue to derive strength from adequate capitalisation of the bank over the last few years supported by significant amount of equity capital infusion by GOI largely through recapitalisation bonds, the bank's established franchise especially in the Eastern and Northern India, improvement in advances and profitability over the last three years.
The ratings continue to be constrained on account of weak but improving asset quality and moderate resource profile with lower-than-average proportion of Current Account Savings Account (CASA) deposits as compared to peer banks. The higher-than-expected slippages would further deteriorate the asset quality parameters and profitability and will be key rating sensitivity.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Consistent improvement in profitability
- Improvement of capitalisation cushion over 3.5% over minimum regulatory requirements on a sustained basis
- Significant improvement in the size of the bank
- Improved asset quality parameters, with net stressed assets/tangible net worth below 25% on a sustained basis

Negative factors

- Material dilution of GOI support
- Deterioration in asset quality parameters with Net NPA ratio of over 5% on a sustained basis.
- Decline in profit for a sustained basis leading to deterioration in capitalisation levels below 12.5%.

Analytical approach

The ratings are based on standalone profile of the bank and factors in strong and continued support from OI, which holds majority shareholding in the bank.

Key strengths

Majority ownership and support by GOI

GOI continues to be the majority shareholder holding 95.39% stake in UCO as on December 31, 2022. GOI has been supporting public sector banks with regular capital infusions and steps to improve capitalization, operational efficiency and asset quality. On account of weak asset quality, leading to higher credit cost, UCO reported net losses during FY16 to FY20 which impacted the capitalisation levels of the bank requiring GOI support to help the bank maintain minimum regulatory capital. From FY16 onwards, GOI has cumulatively infused equity capital aggregating to ₹22,645 crore, including by way of recapitalisation bonds.

Improvement in capitalisation levels

Periodic capital infusion by GOI, improvement in asset quality along with improvement in profitability leading to accretion to networth has helped the bank improve its capitalisation over the last three years.
In line with RBI amendment to 'Master Direction - Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2021' dated March 31, 2022, UCO had fair valued the investments in zero-coupon recapitalisation bonds of ₹2,600 crore received during FY21 adjusting its Common Equity Tier (CET) I ratio. Accordingly, UCO reported stable capital

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

adequacy ratio (CAR) of 13.74% (CET1 and Tier I CAR: 10.97%) as on March 31, 2022 as compared with CAR of 13.74% (CET1 and Tier I CAR: 11.14%) as on March 31, 2021. The capitalisation did not improve despite improvement in profits due the impact of RBI notification. The bank also raised ₹500 crore Tier II capital during FY22 (9MFY23: Nil). UCO reported CAR of 14.32% (CET1 and Tier I CAR: 11.57%) as on December 31, 2022 due to accretion of profits for 9MFY23. The bank has board approvals to raise upto ₹1,000 crore Tier I capital by FY24.
Given the majority ownership of GOI, UCO Bank is expected to receive timely and adequate support in the form of capital as and when required.

Established franchise especially in Eastern and Northern India
Established in 1943, UCO has a long and established operational track record with significant presence of branches (approximately 63% of total branches) in North and Eastern India. Furthermore, 67% of total deposits and 48% of gross advances translating into approximately 60% of total business of UCO are generated from these regions as on December 31, 2022.

Improving advances growth led by wholesale lending
The advances book contracted from peak of ₹1,51,812 crore as on March 31, 2015 to ₹1,18,405 crore as on March 31, 2021 as under prompt corrective action (PCA), various restrictions on lending were imposed and UCO continued to write off bad assets. However, as the bank came out of PCA in September 2021, the advances book started growing again with the entire incremental growth coming from corporate segment whereas non-corporate segment represented by retail, agriculture and MSME (RAM) degrew during FY22 and saw moderate growth during 9MFY23. The gross advances stood at ₹1,51,059 crore as on December 31, 2022, with a growth of 20.35% y-o-y (March 31, 2022: ₹1,29,777 crore with 9.60% growth y-o-y). The bank's Credit to Deposit (C/D) ratio is improving with growth in advances however it continues to remain low at 54.80% as on March 31, 2022 (September 30, 2022: 59.59%) as under PCA with restriction on advances, excess funds were parked in investments (including recapitalisation bonds) instead of lending. CARE Ratings Limited (CARE Ratings) expects the bank's advances growth to be driven by the RAM segments (constituting around 53% of total advances as on December 31, 2022) and higher-rated corporates which have been focus of the bank in the recent years.

Improving profitability due to lower credit cost
UCO's earning profile has been impacted by the weak asset quality due to which the bank was not been able to post profits from FY16 to FY20. However, the bank has seen improvement in profitability from FY21 due to improvement in operating profit and lower credit costs.
During FY22, UCO saw 9.60% growth in advances largely driven by increase in lending corporate segment, which constituted 42% of the total advances as on March 31, 2022. The bank's net interest margin (NIM) improved marginally to 2.61% for FY22 against 2.36% for the previous year due to higher fall in the cost of deposit as compared to fall in the yields in a decreasing interest rate scenario except for the last quarter for FY22 when the interest rates started rising. The bank's non-interest income reduced during FY22 compared with the previous year because of the significant lower treasury profits despite higher recoveries from written-off accounts. However, supported by high net interest income (NII), UCO's Pre-Provisions Operating Profit (PPOP) improved from ₹4,149 crore for FY21 to ₹4,797 crore for FY22. As the bank had made higher provisions during FY21 and earlier years, the incremental provisions for FY22 were lower which resulted in the credit cost to reduce from 1.82% in FY21 to 1.23% in FY22 helping the bank to report profit after tax (PAT) of ₹930 crore during FY22 as compared with net profit of ₹167 crore for FY21, translating into return on total assets (ROTA) of 0.37% for FY22.
During Q1FY22, the bank has set-off its accumulated losses of ₹12,657.03 crore against the securities premium account in line with Gazette notification no. CG-DL-E-23032020-218862 (S.O. 1200 E) dated March 23, 2020 and after receiving approval of RBI on June 9, 2021.
During 9MFY23, the bank continued to see increase in its NII due to advances growth, which has more than off-set the decline in the non-interest income caused largely due to reduction in treasury income and other non-interest fee income resulting in 22% (y-o-y) decline in pre-provision operating profit to ₹2,983 crore as compared with ₹3,848 crore for 9MFY22. The bank saw significant reduction in credit costs with lower provisioning resulting in the bank reporting PAT of ₹1,281 crore for 9MFY23 as compared with ₹618 crore for 9MFY22. As on December 31, 2022, the bank had no accumulated losses. CARE Ratings expects the profitability of the bank to improve in the coming quarters with stable NIM and lower credit costs.

Key weaknesses
Weak but improving asset quality parameters
The asset quality parameters have seen improvement in the last three years (FY20 onwards) after a deteriorating trend which started rising from FY16 onwards and peaked in FY19 with Gross NPA ratio of 25%, Net NPA ratio of 9.71% and Net NPA to Net worth ratio of 148.96% as on March 31, 2019, largely on account of exposure to weaker large-ticket corporate accounts. The Gross NPA declined from FY20 onwards owing to lower slippages (total of ₹17,030 crore from FY20 to 9MFY23 as against ₹34,026

crore from FY16 to FY19 and higher write-offs (₹24,981 crore from FY20 to 9MFY23 as against ₹9,092 crore from FY16 to FY19). As a result, the bank was able to bring down the Gross NPA ratio significantly to 5.63% as on December 31, 2022. The bank's Net NPA, Provision Coverage Ratio (excluding Technical Written Off) and Net NPA to Net worth stood at 1.66%, 71.70% and 17.53% respectively as on December 31, 2022.
UCO's standard restructured assets (including the RBI Resolution Framework 1.0 and 2.0) continued to remain moderate at ₹4,102 crore constituting 2.72% of gross advances as on December 31, 2022, and Emergency Credit Line Guarantee Scheme (ECLGS) outstanding of ₹1,647 crore (1.09% of Gross Advances) as on December 31, 2022. The bank's special mention accounts (SMA), i.e., SMA 1 and SMA 2 excluding restructured accounts stood at 3.15% of gross advances as on December 31, 2022. CARE Ratings expects the asset quality to continue improving going forward.

Moderate resource profile with dependence on bulk deposits
The low-cost CASA of UCO grew significantly, registering a growth of 7.7% Y-O-Y as on December 31, 2022, compared to the corresponding date of the previous year. Although there has been an improvement in absolute numbers, the share of CASA deposits in total deposits remained relatively moderate at around 36.94% as on December 31, 2022 (March 31, 2022: 39.42%) lower as compared to average of public sectors banks. With the recent rate hikes coupled with fast credit growth the entire banking industry have witnessed difficulty in growing their deposits especially CASA with banks, placing more reliance on bulk deposits. The bank has been focused on granularization of deposits and increasing the proportion of its low-cost CASA deposits. While majority of the deposits were granular with ticket size of less than ₹15 lakh, the proportion of bulk deposits (ticket size of above ₹2 crore) was higher at 21.89% with deposits with ticket size of over ₹100 crore constituting 9.70% of total domestic deposits as on September 30, 2022. The proportion of bulk term deposits has increased since March 2021.

Liquidity: Adequate

According to Structural Liquidity Statement as on December 31, 2022, there are no negative cumulative mismatches as per the ALM above in time buckets upto three months. The bank manages its deposit maturities in a particular time bucket by appropriately modifying deposit rates. The bank's average Liquidity Coverage Ratio (LCR) stood at 181% for the quarter ended December 31, 2022, as against the regulatory requirement of 100%. Comfort can be drawn from the excess Statutory Liquidity Ratio (SLR) maintained by UCO at 11.28% of net demand and time liabilities as on December 31, 2022. Furthermore, the bank has access to systemic liquidity like RBI's LAF and MSF facility along with access to refinance from SIDBI, NHB, NABARD, etc and access to call money markets.

Applicable criteria

Policy on default recognition
Factoring Linkages Government Support
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Rating Basel III - Hybrid Capital Instruments issued by Banks
Bank

About the company and industry

Industry Classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Banks	Public Sector Bank

UCO Bank, incorporated in 1943, is a Kolkata-based mid-sized public sector bank that operates through a network of 3,108 branches as on September 30, 2022 with branch concentration in North and East India. In October 2003, GOI divested 25% stake through an initial public offering (IPO) of equity shares. However, post many capital infusions over the subsequent years, GOI shareholding has been steadily increasing and stood at 95.39% as on December 31, 2022. Post the asset quality review (AQR) by RBI, the bank saw significant increase in its NPAs resulting in the bank having to make provisions which impacted the profitability and capital adequacy of the bank. UCO was put into PCA framework by RBI in May 2017 and was subsequently removed from the PCA in September 2021 after it met the parameters under the framework.
UCO is sponsor of Paschim Banga Gramin Bank (PBGB) which is a regional rural bank (RRB), head quartered at Howrah, West Bengal with four regional offices and 230 branches as on December 31, 2022.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	9MFY23 (UA)
Total income	17,870	18,082	14,212
PAT	167	930	1,281
Total Assets	2,40,607	2,55,832	2,84,561
Net NPA (%)	3.94	2.70	1.66
ROTA (%)	0.07	0.37	0.63

A: Audited; UA: Unaudited

Status of non-cooperation with previous CRA:
Not Applicable
Any other information:

Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Basel III Tier II	INE691A08088	31-Mar-2022	8.51%	31-Mar-2032	100.00	CARE AA-; Stable
Basel III Tier II	Proposed	-	-	-	400.00	CARE AA-; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (23-May-19)
2	Bonds-Tier II Bonds	LT	500.00	CARE AA-; Stable	-	1)CARE AA-; Stable (24-Mar-22)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Tier II Bonds	Detailed explanation
Covenants	
Call option	After 5 years onwards at the discretion of the issuer
Write-down trigger	PONV Trigger, in respect of the bank means the earlier of: (i) a decision that a principal write-down, without which the bank would become non-viable, is necessary, as determined by the RBI; and (ii) the decision to make a public sector injection of capital, or equivalent support, without which the bank would have become non-viable, as determined by the RBI.
If write-down, full or partial	Full or partial
If write-down, permanent or temporary	Permanent
If temporary write-down, description of write-up mechanism	Not Applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Tier II Bonds	Complex

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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