UCO Bank

March 24, 2022

Ratings

Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Tier II Bonds (Basel III)[&]	500.00	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Assigned
Total Long-term Instruments	**500.00 (Rs. Five hundred crore only)**		

Details of instruments 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.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the proposed debt instruments of UCO Bank (UCO) factor in the majority ownership, the demonstrated and expected continued support in terms of capital and management from Government of India (GOI), improvement in the 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, moderate resource profile characterised by improvement in Current Account Savings Account (CASA) proportion.

The rating also positively factors in that the bank has come out of the Prompt Corrective Action (PCA) of RBI in September 2021 following the improvement in asset quality parameters and consistent quarter-on-quarter profits made by UCO since the quarter ended March 2020 after reporting net loss for five years (from FY16 to FY20); although the profitability continuous to be low and vulnerable to asset quality shocks.

The ratings continue to be constrained on account of muted advances growth, weak asset quality parameters with sizeable proportion of Gross Advances being stressed (including SMA 2 and restructured portfolio). CARE Ratings also factors in expectation of higher slippages during Q4FY22 mainly on account of retail, agriculture and MSME (RAM) portfolio as the moratorium period ends and due to one large corporate account. The higher-than-expected slippages would further deteriorate the asset quality parameters and profitability and will be key rating sensitivity.

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Consistent improvement in profitability leading to improvement of capitalisation.
- 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- Factors that could lead to negative rating action/downgrade:

- Material dilution of GOI support
- Decline in asset quality parameters with Net NPA ratio of over 5% on a sustained basis.
- Incurring net loss leading to deterioration in capitalisation levels

Detailed description of the key rating drivers

Key Rating Strengths

Majority ownership and support by Government of India (GOI) and demonstrated support

GOI continues to be the majority shareholder holding 95.39% stake in PSB as on December 31, 2021. GOI has been supporting public sector banks with regular capital infusions and steps to improve capitalization, operational efficiency and asset quality. 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. From FY16 onwards, GOI has cumulatively infused equity capital aggregating to Rs.22,645 crore including by way of recapitalisation bonds of Rs.18,410 crore. These bonds are interest-bearing bonds (except Rs.2,600 crore issued during Q1FY22) issued at par having maturities between 10 years and 15 years, held under HTM category and would be redeemed at par on maturity. As per the recent RBI suggestion, zero coupon bonds have to be valued at the net present value and not at face value. This would impact the capitalisation level of UCO to some extent. However, the capitalisation is still expected to be at comfortable levels over minimum regulatory requirement.

Improvement in capitalisation levels post equity infusion

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. Post multiple

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

infusions of equity, the bank has seen improvement in its capitalisation ratios and the bank reported capital adequacy ratio (CAR) of 13.74% (CET1 and Tier I CAR: 11.37%) as on March 31, 2021 and 14.56% (CET1 and Tier I CAR: 11.73%) as on December 31, 2021 as compared with CAR of 9.63% (CET1:7.52% and Tier I CAR: 7.63%) as on March 31, 2016.
During Q1FY22, the bank has set-off its accumulated losses of Rs.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.

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 73%) 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, 2021.

Moderate resource profile characterised by rising CASA deposits
The bank is focused on granularization of deposits and increasing the proportion of its low-cost CASA deposits. As a result, CASA deposits of UCO saw a consistent improvement over the years rising from 31.40% of total deposits as on March 31, 2017 to 39.16% of the total deposits as on March 31, 2021 (December 31, 2021: 38.11%). Total deposits also increased moderately from Rs.2,01,285 crore as on March 31, 2017 to Rs.2,05,919 crore as on March 31, 2021 (December 31, 2021: Rs.2,18,803 crore).

Key rating weaknesses
Muted advances growth
The advances book saw a de-growth from peak of Rs.1,51,812 crore as on March 31, 2015 to Rs.1,18,405 crore as on March 31, 2021 (December 31, 2021: Rs.1,25,519 crore) as under PCA, various restrictions on lending were imposed and UCO continued to write off bad assets due to which the advances book did not grow. The bank's Credit to Deposit (C/D) ratio continued to remain low at 57.50% as on March 31, 2021 (December 31, 2021: 57.37%) as in the absence of advance growth, excess funds were parked in investments (including recapitalisation bonds) instead of lending under PCA. Investments as a proportion of total assets continue to be high at 39% as on March 31, 2021 (December 31, 2021: 38%) As the bank has come out of the PCA framework, the bank's advances portfolio is expected to increase in the near term; however, the management has indicated that the bank's focus would continue to be on the RAM segment and higher-rated corporate advances.

Improving asset quality parameters; however, proportion of stressed portfolio continues to be at elevated level
The asset quality parameters have seen improvement in the last two 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 Rs.9,283 crore for FY20 and FY21 as against Rs.34,026 crore from FY16 to FY19, partly on account of Supreme Court directives for non-recognition of NPA during FY21) and higher write-offs (Rs.21,889 crore for FY20 and FY21 as against Rs.9,092 crore from FY16 to FY19). As a result, the bank was able to bring down the Gross NPA ratio significantly to 9.59% as on March 31, 2021 and further to 8.00% as on December 31, 2021. The bank's Net NPA, Provision Coverage Ratio (excluding TWO) and Net NPA to Net worth stood at 3.94%, 61.33% and 47.03% respectively as on March 31, 2021 (2.81%, 66.80% and 31.39% respectively as on December 31, 2021).
For the nine months ended December 31, 2021, slippages increased to 5.27% (FY21:2.70%) due to removal of stay on non-recognition of NPA by Supreme Court order and the impact of the second wave of covid-19.
Furthermore, UCO continues to have high proportion of standard restructured book (including the RBI Resolution Framework 1.0 and 2.0) and Special Mention Accounts 2 pools (SMA 2) constituting 6.11% of gross advances as on December 31, 2021. The bank has outstanding Guaranteed Emergency Credit Line (GECL) amounting to Rs.1,637 crore as on December 31, 2021 which supports MSME exposure of around Rs.8,200 crore.
As majority of large stressed accounts in corporate portfolio are already recognized, the slippages from corporate portfolio is expected to be lower than in the past. CARE Ratings takes cognizance of UCO's management expectation of higher slippages during Q4FY22 mainly on account of retail, agriculture and MSME (RAM) portfolio as the moratorium period ends on some accounts and due to one large corporate account. The higher-than-expected slippages would further deteriorate the asset quality parameters and profitability and will be key rating monitorable.

Weak profitability with improvement from FY21
UCO's earning profile has been moderate with relatively lower Net Interest Income (NII) as compared to other public sector banks due to interest reversals on account of high slippages resulting in volatile NIM in the range of around 1.4% to 2.6% during FY17 to 9MFY22. Although the bank has been reporting pre-provisioning operating profits (PPOP), higher provisioning over the years for the weak assets had impacted the overall profitability of the bank resulting in continuous losses from FY16 to FY20 (cumulative losses of Rs.15,472 crore). However, the bank started reporting net profit from Q4FY20 onwards. UCO Bank reported a profit after tax (PAT) of Rs.167 crore for FY21 (FY20: Net loss of Rs.2,437 crore) translating into Return on Total Assets (ROTA) of 0.07% during FY21 (9MFY22: PAT of Rs.618 crore, ROTA of 0.34%) helped by lower provisions, recoveries from written off accounts and higher treasury profits.
In addition, the investment book of the bank is relatively higher constituting 38% of total assets as on December 31, 2021. The modified duration of the investment portfolio stood high which may impact the profitability in the near future with interest rates tightening up is a key monitorable.

The recoveries from written off accounts will continue to be elevated and provisions are likely to be comparatively lower going forward may help it post consistent profits in the medium term.

Liquidity: Strong
According to Structural Liquidity Statement as on December 31, 2021, there are no negative cumulative mismatches as per the ALM above in time buckets upto six 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 204.68% for the quarter ended December 31, 2021, as against the regulatory requirement of 100%. Comfort can be drawn from the excess Statutory Liquidity Ratio (SLR) maintained by UCO at 12.58% of net demand and time liabilities as on December 31, 2021. 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.

Analytical approach:
The ratings are based on standalone profile of the bank and continue to factor in strong support from Government of India (GOI) which holds majority shareholding in the bank.

Applicable Criteria
Rating Outlook and Credit Watch
Policy on default recognition
Financial Ratios - Financial Sector
Rating Methodology: Notching by factoring linkages with Government
Bank
Rating Basel III - Hybrid Capital Instruments issued by Banks

About the Company
UCO Bank, incorporated in 1943, is a Kolkata-based mid-sized public sector bank that operates through a network of 3,073 branches as on December 31, 2021 with branch concentration in North and East India. In October 2003, Government of India (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, 2021.
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 Bank was put into prompt corrective action (PCA) framework by RBI in May 2017 on account of high net non-performing assets and a negative return on assets. PCA is a structured early intervention and resolution initiated by RBI for banks that become under-capitalised due to poor asset quality or vulnerable due to loss of profitability. PCA entails restrictions on dividend distribution or remittance of profits, requirement on the promoters to bring in more capital, restrictions on branch expansion, higher provisioning requirement, and restrictions on management compensation. UCO Bank was subsequently removed from the PCA in September 2021 after it met the parameters under the framework.
UCO Bank 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, 2021.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	9MFY22 (UA)
Total operating income	18,006	18,166	13,721
PAT	-2,437	167	618
Total Assets	2,24,198	2,40,607	2,50,961
Net NPA (%)	5.45	3.94	2.81
ROTA (%)	-1.10	0.07	0.34

A: Audited; UA: Unaudited
Note: All Analytical ratios are as per CARE Ratings Ltd's calculations

Status of non-cooperation with previous CRA:
Not Applicable

Any other information:
Not Applicable

Rating History for last three years: Please refer Annexure-2

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

Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Tier II Bonds (Basel III)	-	Proposed	-	-	500.00	CARE AA-; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (04-Jul-18)
2	Bonds-Lower Tier II	LT	-	-	-	-	1)Withdrawn (23-May-19)	1)CARE A+; Negative (21-Nov-18) 2)CARE A+; Stable (04-Jul-18)
3	Tier II Bonds (Basel III)	LT	500.00	CARE AA-; Stable				

* Long Term / Short Term

Annexure-3: Detailed explanation of covenants of the rated instrument – Not Available

Tier II Bonds (Basel III)	Detailed explanation
Covenants	
Call option	Applicable
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 various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Tier II Bonds (Basel III)	Complex

Annexure 5: Bank Lender Details for this Company

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

Note on complexity levels of the rated instrument: CARE Ratings Ltd. 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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About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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