

Rating Rationale for UCO Bank’s Upper Tier II Bonds Issue of Rs. 175 Cr

Brickwork Ratings assigns “BWR AA” for UCO Bank’ Upper Tier II Bonds Issue of INR 1.75 billion

Issue Rating: BWR AA

Outlook: Positive

Brickwork Ratings has assigned BWR AA (Pronounced BWR double A) for UCO Bank’s proposed Upper Tier II Capital Bonds issue of INR 175 crore or INR 1.75 billion. The rating factored improving operating profits, improving asset quality and returns, diversified credit deployment, and the Government of India’s equity stake.

In spite of the economic slowdown in the international markets and the consequent ripples in the domestic market, UCO Bank has posted improved operating performance during FY 09 compared to the previous year. The Bank showed a total business (INR 1698.90 billion) growth of 25.34% in FY 09 with the total advances (INR 696.69 billion) and deposits (INR 1002.21 billion) growing by 25.24% and 25.42% respectively.

The Bank’s asset quality has been improving for the last four quarters as is shown in the following table.

	Q1 FY 09	Q2 FY 09	Q3 FY 09	Q4 FY09
GNPA	2.82%	2.58%	2.42%	2.21%
NNPA	1.91%	1.61%	1.28%	1.18%

The Bank has posted moderate revenues and profit figures with improvement in core income and significant non-interest income. As a result, the bank’s operating (INR 12.01 billion) and net profits (INR 5.57 billion) surged 25.99% and 35.44% respectively during FY 09.

In FY 09, the bank’s CASA deposits stood at 24.11% (25.65% in FY08), which is significantly lower than its peers’ average of 30.78%. The bank has recorded lower capital adequacy ratio of 9.75% under Basel I norms in FY 09, as against 10.09% in FY08, which is also significantly lower than its peers’ average of 12.49%. Similarly, the bank’s Tier I capital stood at 5.05%, which is 358 bps lower than that of peers in FY 09. Overall, the rating has factored the bank’s improving business performance, improving asset

quality and efforts being made to reduce the NPAs and Government of India ownership. It has also taken into account the Bank's performance vis-à-vis the performance of the peers.

Table I: UCO Bank's Improving Performance

Criteria (INR Billion)	FY 09	FY 08	FY 07
Deposits	1002.21	799.09	648.60
Demand and Saving Deposits	241.64	205.06	189.36
Term Deposits	760.57	594.03	459.23
Advances	696.69	556.27	474.71
Non-Performing Assets			
Gross NPAs	2.21%	2.97%	3.17%
Net NPAs	1.18%	1.98%	2.14%
Profit			
Operating Profit	12.01	9.54	9.45
Net Profit	5.57	4.12	3.16
ROA	0.59%	0.52%	0.49%
Business per Employee	0.07	0.05	0.04
Investments	293.85	246.29	197.89
Branches	2,069	1,961	1,849

The Bank has posted decent performance despite the fact that financial year 2008-09 has witnessed many challenges like tough monetary condition, high inflation, high cost of deposits and borrowings. As a result, the Bank's total business had increased by 25.34% during FY 09 to reach INR 1698.90 billion from INR 1355.36 billion for the same period in 2008.

The Bank has achieved a 25.42% growth in total deposits during FY09. The Bank's total deposits stood at INR 1002.21 billion, as compared to INR 799.09 billion a year ago. In line with mid-sized public sector banks in India, the Bank is also mostly funded through term deposits. The term deposits of UCO Bank account for 75.88% of total deposits.

The Bank's global advances grew by 25.24% to reach INR 696.69 billion during FY09 as against INR 556.26 billion during FY08. The Bank's credit to deposit ratio has marginally decreased to 69.51% in FY09 as compared to 69.61% in FY 08.

The bank's asset quality has been gradually improving with better enforcement of credit culture and monitoring. As a result, the bank's gross NPAs have come down to 2.21% as on 31st March 2009 from 2.97% for the same period a year ago. The Bank's net NPAs have shown a similar trend, which has declined to 1.18% in FY09 from 1.98% in FY08. The sustained improvement in the bank's asset quality is significant keeping in view the strong loan growth witnessed during the year. Further, the improvement in the Bank's asset quality is clearly visible with declining gross and net NPAs.

The bank has been consistently generating profit over the years. The bank has posted growth in revenues and profits, with total income of INR 91.42 billion in FY09 as against INR 72.81 billion in FY 08, reflecting significant improvement in core banking operations, and fee based activities. The bank is focusing on building healthy earning assets, which has contributed to improvement in profitability. The bank's operating and net profits increased to INR 12.02 billion (INR 9.54 billion in FY 08) and INR 5.58 billion (INR 4.12 billion) respectively during FY09 scaling new heights in profitability.

Table II: UCO Bank Financials

Financials (INR Billion)	2008-09	2007-08
Interest Income	81.22	65.08
Interest Expenses	64.77	50.20
Net Interest Income	16.45	14.88
Other Income	10.20	7.72
Operating Income	26.65	22.60
Operating Expenses	14.63	13.06
Operating Profits	12.02	9.54
Provisions & Contingencies	6.44	5.42
Profit After Tax	5.58	4.12

During FY09, the financial markets around world forced the banks to change its risk-return trade off and business outlook drastically to survive from sub-prime collapse. Further, the world has witnessed large write off by major financial institutions and banks. As a result, the bond spreads have increased and liquidity drained in the corporate bond markets across countries. The bank has maintained its treasury operations reasonably well during this period. Investment decisions of the bank are

guided by the risk management policy approved by the bank's Board. During FY09, the total gross Investments of the bank increased by 19.31 per cent. The total gross investments of the bank as on 31.03.2009 stood at INR 293.85 billion.

During FY09, the bank's Return on Assets stood at 0.59%, slightly higher than the previous year figure of 0.52%. Similarly, the bank's business per employee has improved to INR 73.20 million in FY09 as against INR 58.00 million in FY08.

UCO Bank Vs Peer Group

BWR has analyzed the performance of UCO Bank vis-à-vis its peers in certain key parameters as given in the table above. BWR rating methodology has defined peer banks as those with closely similar size/operation as that of UCO Bank.

Table II:

Key Ratios	UCO	Peers
Capital Adequacy (Basel I)		
CRAR	9.75%	12.49%
Tier I	5.05%	8.63%
Asset Quality (As % of Advances)		
Gross NPA	2.21%	1.74%
Net NPA	1.18%	0.73%
Earnings		
NIM	1.75%	2.81%
Non-Interest Income (INR Billion)	10.20	11.27
ROA	0.59%	1.10%
Cost to Income Ratio	54.89%	43.85%
Liquidity		
CASA	24.11%	30.78%
Credit Deposit Ratio	68.98%	71.59%
Operating Ratios		
Cost of Deposits	7.25%	7.15%
Yield on Advances	10.67%	10.19%

UCO Bank has the lowest capital adequacy ratio amongst its peers. As of 31st March 2009, the CRAR under Basel I was 9.75%, which has significantly declined from 10.09% for the same period a year ago. Capital adequacy was 274 bps lower than its peers' average of 12.49% as on 31st March 2009. Similarly, the bank's tier I capital stood at

5.05%, which is 358 bps lower than that of peers. As approved by the Government of India (GoI) on 11th February, 2009 to infuse INR 12.00 billion in the in two tranches , 1st tranche of INR 4.50 billion has already been infused in the form of PNCPs (Perpetual Non-cumulative Preference Shares) during the financial year ended 31st March, 2009.

Remaining INR 7.50 billion is expected to be infused during the current financial year. The CRAR is expected to improve further with the proposed issue of upper Tier II capital issue of INR 1.75 billion. The bank put in place new capital adequacy framework to look after the Basel II norms implementation. The Bank has adopted the Standardized Approach for Credit Risk and Basic Indicator Approach for Operational Risk under the Revised Framework with effect from 31st March 2008. As on 31st March 2009, the Bank's capital adequacy under Basel II is 11.93%.

The bank 's asset quality has improved during FY 2009.. As a result, the bank's gross and net NPAs had come down to 2.21% and 1.18% respectively during the year. However, the bank's gross and net NPAs are still 47 and 45 bps higher than its peers' average of 1.74% and 0.73% respectively.

During FY09, the bank's net interest margin was 106 bps lower than its peers' average. Similarly, the bank's non-interest income of INR 1.07 billion is lower than its peers' average of INR 11.27 billion during FY09. Further, the bank's ROA is also significantly lower (51 bps) than its peers'.

The bank's composition of low-cost deposits to total deposits stood at 24.11%, lower than peers' average of 30.78%. Credit deposits ratio stood at 68.98%, which is 261 bps lower than its peers' average of 71.59%.

It is observed that the bank has the highest cost of deposits among its peers as on 31st March 2009, which has dipped the net interest. However, the bank's yield on advances is comparatively higher (48 bps) than its peers' average of 10.19%.

Shortcomings:

While analyzing the UCO Bank's performance for FY 2009, a few shortcomings as under have been noticed.

- a) Share of CASA deposits has slipped from 25.65% as of 31st March 2008 to about 24.11% in FY09.
- b) Cost of deposits has increased from 6.74% in FY08 to 7.25% in FY09
- c) Net interest margin declined from 1.86% in FY08 to 1.75% in FY09
- d) CRAR declined from 10.09% in FY08 to 9.75% in FY09.

Mitigants:

The bank is making concerted efforts to overcome above said deficiencies by focusing on sustained business growth, continuous monitoring of asset quality, reduction in NPAs, increase low cost deposits, leverage technology to reduce the cost of operation, and systematic profit planning. Overall, the bank is taking appropriate steps for overcoming the deficiencies and improving its performance.

Bank Profile:

Incorporated in 1943, UCO Bank is a mid-sized public sector bank in India. The bank has nearly 2000 Service Units spread all over India and also operates in two Major International Financial Centers namely Hong Kong and Singapore. The bank has correspondents/agency arrangements all over the world to help in its overseas business. Foreign exchange business is conducted in more than 50 centres in India. The Bank has foreign exchange position maintaining offices in four centres in the country.

The bank is a dominant player in the eastern parts of the country. It has presence in other parts as well. The bank's distribution channel consists of 2,065 branches, 4 overseas branches, and 2 representative offices. The bank's product and services consist of NRI banking, foreign currency loans, finance to exporters, forex and treasury services, payments, receipts, and remittance.

The Government of India (GoI) is a major stakeholder of UCO Bank with ownership stake of 74.98%.

Shareholding Pattern (As on 31st March 2008)

Shareholders	Stake
Government of India	74.98%
Financial Institutions	5.05%
Foreign	0.34%
Retail	19.63%

Rating Outlook:

Brickwork Ratings (BWR) issue rating is based on CAMEL-TP framework, which is used to assess the Bank's financial fundamentals and risk exposures. The rating assigned to UCO Bank is specific to the proposed upper Tier II bonds issue of INR 175 crore or INR 1.75 billion. Brickwork feels that the current unstable global economic conditions and the resultant effects on the Indian economy may put some pressure on the Bank's asset quality and the earnings. However, with the consistently improving risk management practices, the efforts being made to bring about better efficiency and improve performance, and the Government of India's expected support in improving Bank's Capital Adequacy, Brickwork Ratings feels that the bank will be in a better position to face the present challenging times and has assigned **Positive Outlook** for the bank's proposed issue.

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