Ind-Ra Downgrades United Bank of India’s Additional Tier 1 Bonds to ‘IND BBB’/Negative; Affirms Long-Term Issuer Rating at ‘IND AA-’/Stable

Ind-Ra-Mumbai-1 August 2016: India Ratings and Research (Ind-Ra) has downgraded United Bank of India’s (UBI) INR2bn Additional Tier-1 (AT1) bonds to ‘IND BBB’ from ‘IND A-’. The Outlook is Negative. The agency has also affirmed the bank’s Long-Term Issuer Rating at ‘IND AA-’ with a Stable Outlook.

Key Rating Drivers

The downgrade on UBI’s AT1 bonds reflects the deterioration in the bank’s standalone credit profile. The new rating also reflects Ind-Ra’s assessment that there is heightened risk of coupon deferral, led by continued pressure on profitability and a negative revenue reserve. Over the past few quarters UBI’s profitability (FY16 profit after tax: loss of INR2.8bn) has seen the impact of decreasing loan growth as well as increasing credit costs. Ind-Ra expects NPL aging and non-funded exposure to stressed corporates (impaired asset ratio of 22.75% as at FYE16; 21.8% as at FY15) to keep UBI’s FY17 credit profile under pressure as well.

For the AT1 instrument, the agency has considered 'discretionary component', 'coupon omission risk' and 'write-down/conversion risk' as the key parameters to arrive at the rating. The agency recognises the unique going-concern loss absorption features that these bonds carry, factoring in a higher probability of an ultimate loss for investors in these bonds. The rating for UBI’s AT1 bonds reflects the bank’s standalone credit profile, along with its ability to service coupons, and its equity requirement to avoid write-down triggers compared with other public sector banks (PSBs).

Standalone Profile and Asset Quality: UBI's standalone credit profile is weaker than that of most mid-sized PSBs on account of its higher exposure to stressed sectors and moderate capitalisation, despite regular infusions by the Government of India (GoI). UBI's liability franchise, however, continues to be robust, reflecting its dominant presence in the eastern parts of India with a current and savings account (CASA) ratio of 41.9% as at FYE16 (highest among peers). Over the past few quarters, the bank's asset quality has seen a significant deterioration, with slippages of INR50.1bn in FY16, leading to a gross NPL ratio of 13.3% and standard restructured loans of 9.5%. Stressed assets continue to remain a concern for UBI and Ind-Ra estimates its credit cost in FY17 to at 190bps-200bps (FY16: 262bps) on account of the aging impact of NPLs recognised under the Reserve Bank of India's asset quality review as well as from previous slippages. UBI's provision coverage ratio declined to 53.3% as at FYE16 from 58.5% as at FYE15.

Capitalisation: As per Ind-Ra's estimate, UBI needs INR25bn (in addition to the proposed infusion of INR8.1bn by GoI in 2QFY17) of Tier I capital over FY17-FY19, which is 43.6% of its FY16 CET1. The estimates assume the maintenance of the minimum CET1 buffer over the Basel III transition period at a bare minimum growth rate needed to absorb Ind-Ra's expected credit costs and operating costs over this period. The bank's liquidity coverage ratio is comfortable at 242%, higher than that of most PSB, on account of a large proportion of stable CASA deposits.

Support Factors: UBI's Long-Term Issuer Rating is driven by Ind-Ra's expectation of continued support from GoI, which is its major shareholder (85.9% as at end-June 2016), given UBI's significant market share in the less banked Eastern and Northeastern regions of the country. The bank has been the beneficiary of steady capital injection by GoI over FY09-FY17. Over the past 12 months, the bank has received INR12.9bn from GoI as a part of the Indradhanush framework (GoI's initiative to rejuvenate PSBs). Despite the challenges listed above, the agency's Stable Outlook on UBI's Long-Term Issuer Rating underlines the agency's expectation of continued support from GoI to prevent the bank from approaching the point of non-viability (PONV) trigger. The support floor for the Long-Term Issuer Rating would continue to remain unchanged unless GoI's support stance changes.

Additionally, Ind-Ra continues to highlight that PSBs would continue to require significant amount of capital even at a constrained growth trajectory during FY17-FY19. Also, following the clean-up under the asset quality review, NPL ageing would keep pressure on credit costs well into FY17.

Rating Sensitivities

Negative: UBI's Long-Term Issuer Rating is at its support floor and could change if there is a change in GoI's support stance.

However, the rating on AT1 bonds (linked to the standalone profile) could be downgraded in case of a significantly higher-than-expected deterioration in asset quality, leading to a sustained period of loss, which would further erode the bank's already negative revenue reserves.

Company Profile

UBI is the largest public sector bank in East India with GoI holding 85.9% at end-June 2016. As at

FYE16, the bank had 2011 branches/offices across India.