

## CITY UNION BANK | Banking

Second wave asset quality impact lower; adequate growth capital

LKP

## Price Analysis

City Union Bank (CUB) has demonstrated consistency in profitability by focusing on risk at a time when most of its peers were looking for scale. Over the last ten decades, CUB leveraged its trust and relationship with SME in its circle of competence by ring fencing the risk. In our view CUB is moving ahead cautiously with lower stress formation. 1QFY22 results were better than our estimates on operational fronts, largely due to healthy non-interest income and lower credit cost v/s our estimate. Growth in NII stood at 2.4% YoY as NIM declined by 12bps YoY but the weakness in NII was offset by ~22% YoY growth in non-interest income.

We expect NIM (revised down) at the lower end of the 3.7-4% range guided by the management. Provisions declined by 28.7% QoQ as CUB utilized ₹830mn of its covid provisioning. Slippages stood at ₹4.82bn and are expected to moderate in the subsequent quarters as most of the recognition has been front-loaded. The management continues to guide that FY22E NPAs and slippages will be lower than FY21. As restrictions are lifted, recoveries and collections should pick up. We estimate ROA/ROE of 1.3%/11.5% for FY23E and recommend BUY with target price of ₹205 (upside of 37%)

**Second wave asset quality impact lower:** During the second wave, fresh stress formation was lower and within management's guidance. Slippages for 1QFY22 were ₹4.82bn and are expected to moderate going forward. Overall slippages for FY22E are expected to be lower than last year, we estimate 3% slippages ratio in FY22 v/s 3.3% in FY21. Total restructuring stood at 5.45% of loans, up 34bps sequentially. Most of the stress came from the services sector (hospitality, tourism, etc.), which has been most impacted due to the lockdowns.

We expect additional ~1.25% restructuring in 2QFY22. Repayment experience on the restructured accounts has been positive so far, with negligible NPA formation. As restrictions are lifted and businesses restarts, we expect normalization of collections and recovery processes to aid asset quality improvement. SMA-2 stood at 3.2% compared to 2% in 4QFY21 but far lower than pre-covid levels of 5-6%.

Key Financials (₹ mn)	FY20	FY21	FY22E	FY23E	FY24E
NII	16,752	18,297	19,796	21,488	23,541
Operating Profit	13,414	14,838	15,789	16,884	18,160
Reported Profits	4,763	5,928	6,052	7,852	9,375
Net Worth	52,961	58,425	64,476	72,328	81,704
Loan & Advances	3,39,274	3,61,578	3,90,505	4,25,650	4,68,215
Int. Bearing Liabilities	4,28,649	4,58,831	4,95,599	5,39,851	5,92,342

Key Ratios (%)	FY20	FY21	FY22E	FY23E	FY24E
NIM's	3.7	3.7	3.7	3.7	3.7
C/I Ratio	43.0	41.5	41.5	41.5	41.5
Gross NPA Ratio	4.1	5.1	5.1	4.9	4.5
Tier 1 Ratio	16.5	18.5	19.1	19.7	20.3
Adj. RoA Ratio	1.0	1.2	1.1	1.3	1.4
Adj. RoE Ratio	9.4	10.6	9.8	11.5	12.2

Rating	Buy
Current Market Price (₹)	150
12 M Price Target (₹)	205
Potential upside (%)	37

## Stock Data

FV (₹) :	1
Total Market Cap (₹ bn) :	111
Free Float Market Cap (₹ bn) :	111
52-Week High / Low (₹) :	132 / 200
2-Year High / Low (₹) :	110 / 249
1 Year Avg. Dly Traded Volume (in lakh)	25
BSE Code / NSE Symbol	532210 / CUB
Bloomberg :	CUBK:IN

## Shareholding Pattern (%)

	Jun-21	Mar-21	Dec-20	Sep-20
FPIs	17.15	18.00	18.65	18.67
MFs	30.95	28.97	27.61	26.78
Bodies Corporate	2.99	3.20	3.58	3.72
Insurance	10.14	9.52	7.03	7.02
Others	38.77	40.31	43.13	43.81

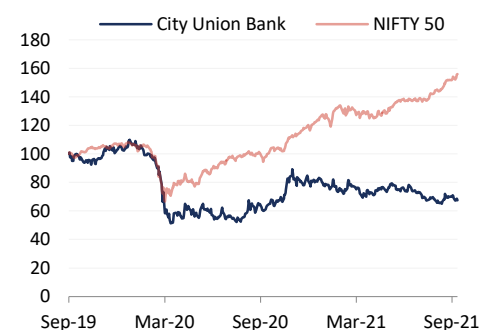
Source: BSE

## Price Performance (%)

(%)	1M	3M	6M	1YR
City Union Bank	2.2%	-13.2%	-8.5%	12.2%
Nifty 50	7.4%	13.1%	22.7%	65.2%

\* To date / current date : September 24, 2021

## City Union Bank vs Nifty 50



**Strong CASA accretion; further headroom to reduce deposit cost:** CASA ratio surged 303bps YoY to 27.6%, which is likely to reduce the COF going ahead. For 1QFY22, the NIM stood at 3.86%, lower than the historical level of 4% and above. Given the abundant liquidity in the system and CDR at lower levels, the management expects near-term NIM of 3.7%-4%. Yields compression has also been a driving factor as the last few quarters have seen growth come from the gold loan segment where the average yield is 8.5%-9%.

**Gold loans to drive credit growth:** Credit flow in 1QFY22 was largely driven by gold loan, agriculture and retail traders. Robust growth in gold loans was driven by excess liquidity in the bank and lower preference for SME loans given the strain faced by this segments. Advances grew 5% YoY to ₹364bn, largely driven by retail loans (mix: 26% v/s 23% in 1QFY21), which grew 20% YoY and the MSME book (mix: 38% v/s 32% in 1QFY21), which grew a healthy 26% YoY.

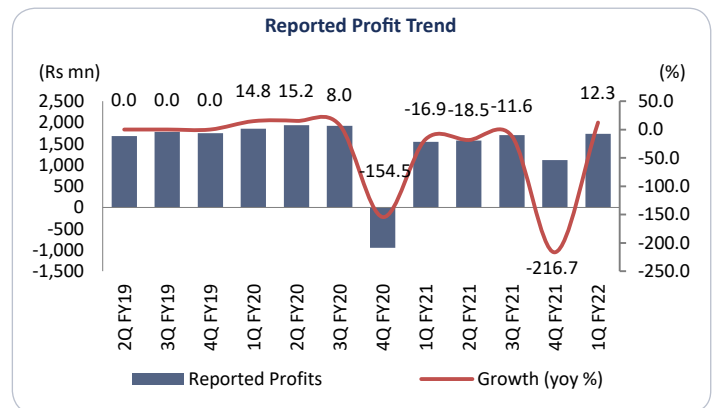
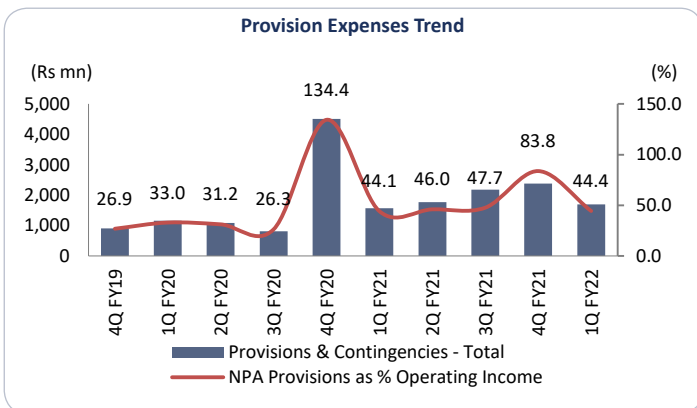
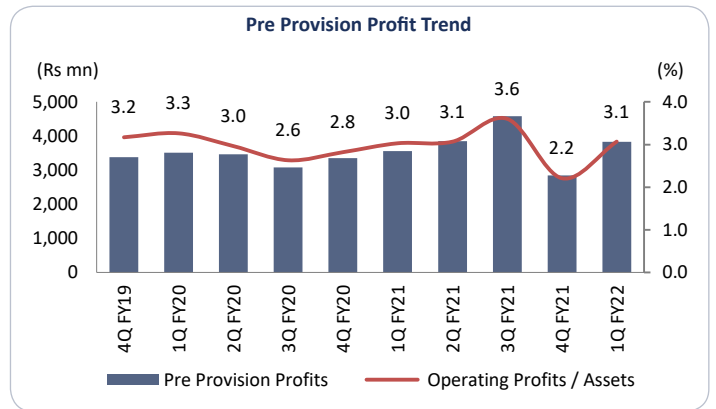
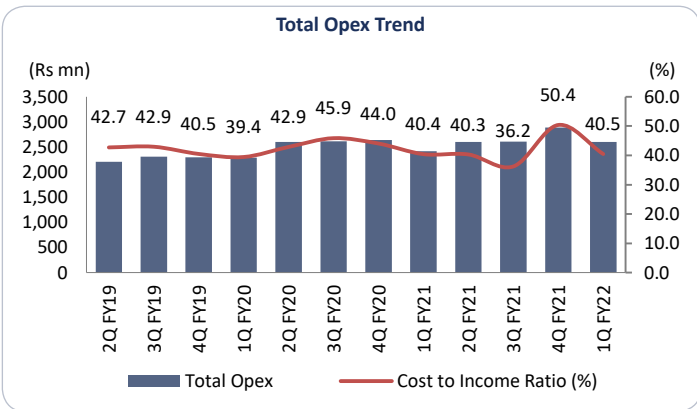
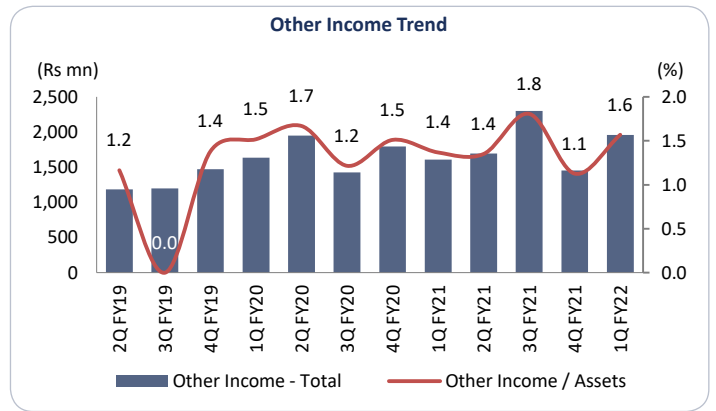
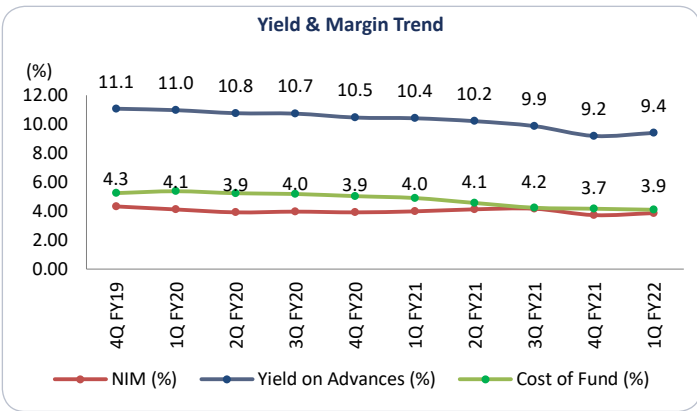
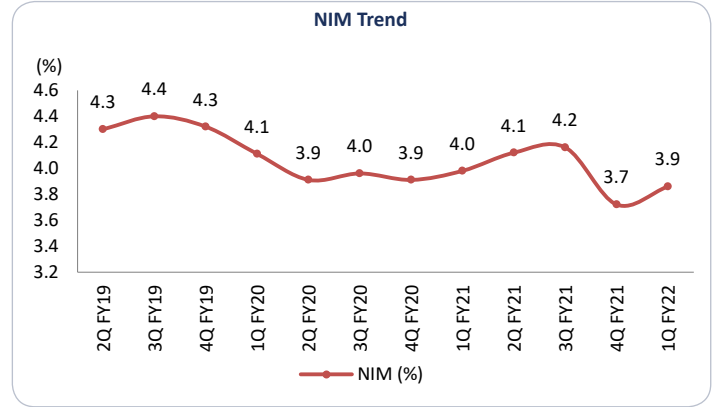
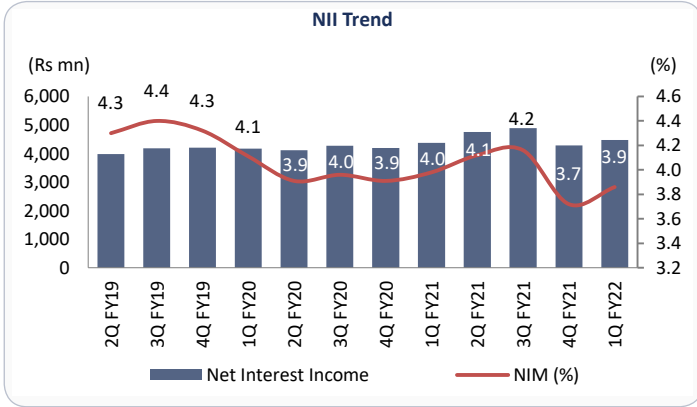
Total ECLGS outstanding is ₹19.5bn as at Jun'21. Gold loan grew 100% YoY (mix: 19% v/s 10% in Q1FY21) to INR 69.1bn, with an average LTV of 69%. For FY22, the bank expects ₹20-25bn gold loan disbursements while overall loan growth guidance is revised lower from the last quarter and could range from 6-9%. We estimate a loan growth of 8% in FY22E and further improvement going forward.

**Adequate capital buffer:** As on 1QFY22, the bank's CRAR stood at 19.6% with core equity capital of 18.5% of RWA. We believe the capital buffer to be adequate to maintain the growth momentum and expect no equity dilution soon. The capital drag down by NPAs from restructuring will be key monitorable.

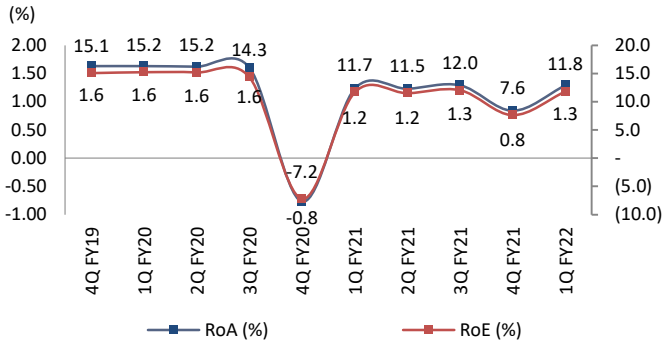
#### Outlook and Valuation

We expect the bank's loan book to grow cautiously at CAGR of ~9% over FY21-23E, led by MSME and retail book growth. In our opinion, the bank's credit cost will normalise by FY22E and estimate return ratio ROA/ROE of 1.3% and 11.5% in FY23E. We value CUB at 2.7x FY23E Adj. BVPS (₹76) and arrive at a target price of ₹205. We recommend BUY with a potential upside of 37%.

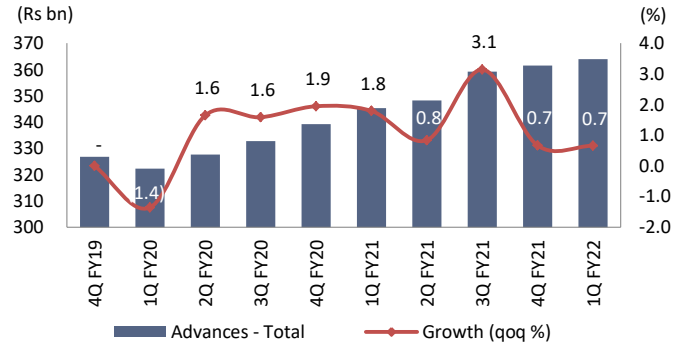
Quarterly story in charts



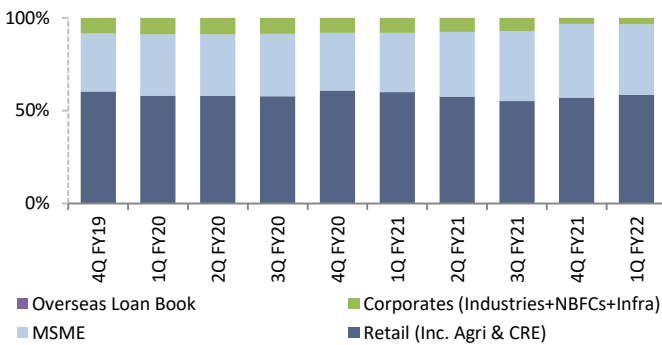
Return Ratio Trend



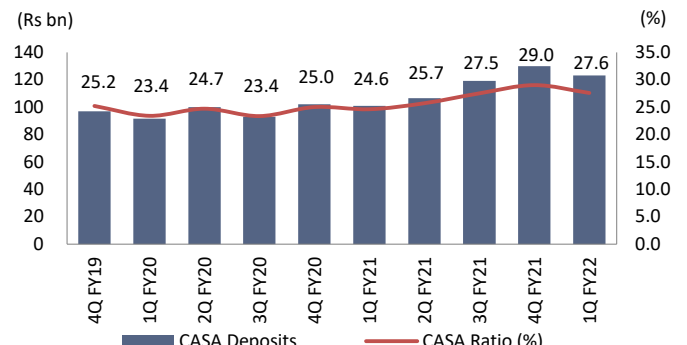
Loan Book Trend



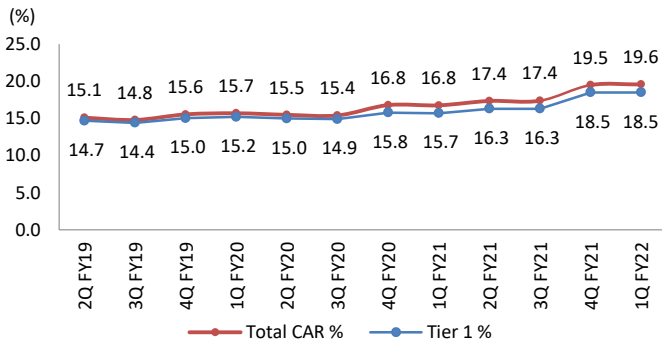
Loan Book Mix Trend



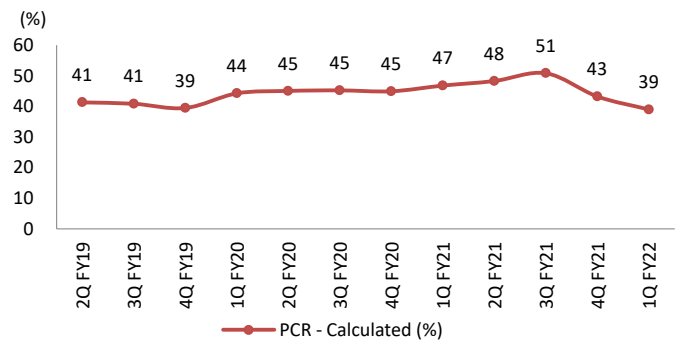
CASA Deposit Trend



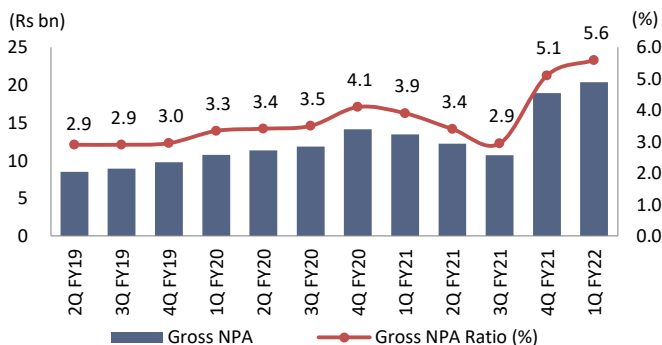
CRAR & Tier 1 Ratio Trend



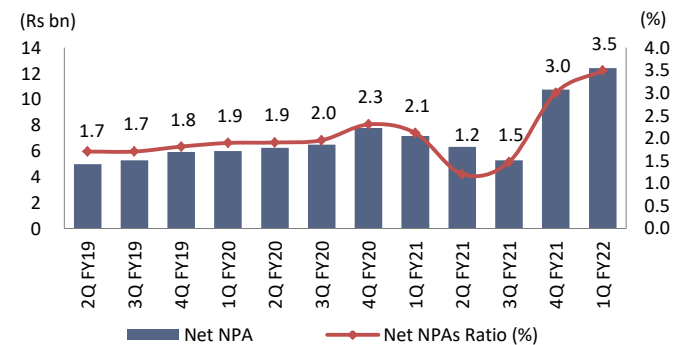
PCR Trend



Gross NPA Trend



Net NPA Trend



## Annual Projections

## Exhibit 1: Profit and Loss Statement

(₹ mn)	FY20	FY21	FY22E	FY23E	FY24E
Int. Income	41,686	41,347	44,283	48,053	52,587
Interest Expenses	24,934	23,050	24,487	26,565	29,047
<b>Net Interest Income</b>	<b>16,752</b>	<b>18,297</b>	<b>19,796</b>	<b>21,488</b>	<b>23,541</b>
<i>NIM (%)</i>	3.68	3.70	3.72	3.72	3.72
<b>Adjusted NII</b>	<b>16,659</b>	<b>18,231</b>	<b>19,796</b>	<b>21,488</b>	<b>23,541</b>
Core Fee Income	554	514	529	545	562
Exchange Income	846	919	997	1,082	1,174
Sale of Investments	1,596	2,334	2,357	2,381	2,405
Other Misc. Income	3,803	3,281	3,313	3,346	3,380
<b>Other Income - Total</b>	<b>6,799</b>	<b>7,048</b>	<b>7,197</b>	<b>7,355</b>	<b>7,520</b>
<b>Net Operating Revenue</b>	<b>23,551</b>	<b>25,344</b>	<b>26,994</b>	<b>28,842</b>	<b>31,061</b>
Employee Exp.	4,207	4,637	5,101	5,611	6,172
Other Opex	5,931	5,869	6,103	6,348	6,728
<b>Total Opex</b>	<b>10,137</b>	<b>10,506</b>	<b>11,204</b>	<b>11,959</b>	<b>12,901</b>
<i>C/I Ratio</i>	43.04	41.45	41.51	41.46	41.53
<b>Pre Provision Profits</b>	<b>13,414</b>	<b>14,838</b>	<b>15,789</b>	<b>16,884</b>	<b>18,160</b>
<i>PPP Growth (yoy %)</i>	8.2	10.6	6.4	6.9	7.6
<b>Provisions &amp; Contingencies - Total</b>	<b>7,551</b>	<b>7,910</b>	<b>8,129</b>	<b>6,945</b>	<b>6,293</b>
<i>Credit Cost (As % of Op. AUM)</i>	2.41	2.28	2.22	1.75	1.45
<b>Profit Before Tax</b>	<b>5,863</b>	<b>6,928</b>	<b>7,660</b>	<b>9,939</b>	<b>11,868</b>
Tax	1,100	1,000	1,609	2,087	2,492
<i>Effective Tax Rate</i>	18.8	14.4	21.0	21.0	21.0
<b>Reported Profits</b>	<b>4,763</b>	<b>5,928</b>	<b>6,052</b>	<b>7,852</b>	<b>9,375</b>
<i>PAT Growth (yoy %)</i>	(30.2)	24.5	2.1	29.7	19.4

Source: Company, LKP Research

## Exhibit 2: Balance Sheet

(₹ mn)	FY20	FY21	FY22E	FY23E	FY24E
Equity Share Capital	737	739	739	739	739
Reserves (ex Reval. Reserve)	52,223	57,686	63,738	71,589	80,965
<b>Net Worth - Ex Revaluation</b>	<b>52,961</b>	<b>58,425</b>	<b>64,476</b>	<b>72,328</b>	<b>81,704</b>
Deposits	4,08,325	4,45,374	4,81,226	5,24,195	5,75,164
Borrowings	20,324	13,457	14,372	15,656	17,178
<b>Interest Bearing Liabilities</b>	<b>4,28,649</b>	<b>4,58,831</b>	<b>4,95,599</b>	<b>5,39,851</b>	<b>5,92,342</b>
<b>Other Lia. &amp; Prov.</b>	<b>15,726</b>	<b>15,861</b>	<b>16,187</b>	<b>15,648</b>	<b>14,777</b>
<b>Total Liabilities</b>	<b>4,97,335</b>	<b>5,33,117</b>	<b>5,76,262</b>	<b>6,27,827</b>	<b>6,88,823</b>
<b>Assets</b>					
Cash & Cash Equivalent	47,216	56,151	61,051	66,537	73,043
Investments	91,168	94,359	1,01,845	1,10,935	1,20,843
Credit Equivalent	417	418	426	435	443
Loan & Advances	3,39,274	3,61,578	3,90,505	4,25,650	4,68,215
<i>Growth (yoy %)</i>	<i>3.8</i>	<i>6.6</i>	<i>8.0</i>	<i>9.0</i>	<i>10.0</i>
Fixed Assets	2,452	2,327	2,664	2,891	3,163
Other Assets	17,225	18,702	20,198	21,814	23,559
<b>Total Assets</b>	<b>4,97,335</b>	<b>5,33,117</b>	<b>5,76,262</b>	<b>6,27,827</b>	<b>6,88,823</b>

Source: Company, LKP Research

## Exhibit 3: Per share data

Y/E Mar	FY20	FY21	FY22E	FY23E	FY24E
Face Value	1	1	1	1	1
Adjusted Share O/S - For Calculation	737	739	739	739	739
Earnings Per Share	6.5	8.0	8.2	10.6	12.7
<b>EPS (% YoY)</b>	<b>(30.5)</b>	<b>24.2</b>	<b>2.1</b>	<b>29.7</b>	<b>19.4</b>
<b>P/E (x)</b>	<b>23.2</b>	<b>18.7</b>	<b>18.3</b>	<b>14.1</b>	<b>11.8</b>
Book Value	71.8	79.1	87.3	97.9	110.6
<b>BVPS (% YoY)</b>	<b>9.0</b>	<b>10.1</b>	<b>10.4</b>	<b>12.2</b>	<b>13.0</b>
<b>P/BV (x)</b>	<b>2.1</b>	<b>1.9</b>	<b>1.7</b>	<b>1.5</b>	<b>1.4</b>
Adj. BV	66.5	71.8	65.4	76.1	88.8
<b>Adj. BV (% YoY)</b>	<b>7.5</b>	<b>7.9</b>	<b>(8.9)</b>	<b>16.2</b>	<b>16.7</b>
<b>P/ABV (x)</b>	<b>2.3</b>	<b>2.1</b>	<b>2.3</b>	<b>2.0</b>	<b>1.7</b>

Source: Company, LKP Research

## Exhibit 4: Detailed ROA Tree

Y/E Mar	FY20	FY21	FY22E	FY23E	FY24E
<b>Yields / Margins</b>					
Yield on Advance	10.5	10.0	10.0	10.0	10.0
Yield on Funds	9.2	8.4	8.3	8.3	8.3
Cost of Funds (CoF)	6.1	5.2	5.1	5.1	5.1
<b>Interest Spread</b>	<b>3.1</b>	<b>3.2</b>	<b>3.2</b>	<b>3.2</b>	<b>3.2</b>
<b>NIM's</b>	<b>3.7</b>	<b>3.7</b>	<b>3.7</b>	<b>3.7</b>	<b>3.7</b>
Interest Income / Assets	8.8	8.0	8.0	8.0	8.0
Interest Exp. / Assets	5.2	4.5	4.4	4.4	4.4
<b>NII / Assets</b>	<b>3.5</b>	<b>3.6</b>	<b>3.6</b>	<b>3.6</b>	<b>3.6</b>
Fee Income / Assets	0.1	0.1	0.1	0.1	0.1
Other Non Core Income / Assets	0.3	0.5	0.4	0.4	0.4
<b>Other Income / Assets</b>	<b>1.4</b>	<b>1.4</b>	<b>1.3</b>	<b>1.2</b>	<b>1.1</b>
<b>Net Operating Income / Assets</b>	<b>5.0</b>	<b>4.9</b>	<b>4.9</b>	<b>4.8</b>	<b>4.7</b>
<b>Operating Ratios</b>					
NII to Net Operative Income	71.1	72.2	73.3	74.5	75.8
Other Income to Net Operative Income	28.9	27.8	26.7	25.5	24.2
Empl. Cost/Oper. Exps.	41.5	44.1	45.5	46.9	47.8
Other Op. Exps./Oper. Exps.	58.5	55.9	54.5	53.1	52.2
<b>C/I Ratio</b>	<b>43.0</b>	<b>41.5</b>	<b>41.5</b>	<b>41.5</b>	<b>41.5</b>
<b>Provisions as % PPP</b>	<b>32.1</b>	<b>31.2</b>	<b>30.1</b>	<b>24.1</b>	<b>20.3</b>
<b>Credit Cost (As % of Op. AUM)</b>	<b>2.4</b>	<b>2.3</b>	<b>2.2</b>	<b>1.8</b>	<b>1.5</b>
<b>Effective Tax Rate</b>	<b>18.8</b>	<b>14.4</b>	<b>21.0</b>	<b>21.0</b>	<b>21.0</b>
Employee Exp. / Assets	0.9	0.9	0.9	0.9	0.9
Other Opex/ Assets	1.2	1.1	1.1	1.1	1.0
<b>Total Opex / Assets</b>	<b>2.1</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>
<b>Operating Profits / Assets</b>	<b>2.8</b>	<b>2.9</b>	<b>2.8</b>	<b>2.8</b>	<b>2.8</b>
<b>Op Profit ex Except Items / Assets</b>	<b>2.8</b>	<b>2.9</b>	<b>2.8</b>	<b>2.8</b>	<b>2.8</b>
Provisions / Assets	1.6	1.5	1.5	1.2	1.0
<b>Profit Before Tax / Assets</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>1.7</b>	<b>1.8</b>
Tax Expenses / Assets	0.2	0.2	0.3	0.3	0.4
<b>RoA</b>	<b>1.0</b>	<b>1.2</b>	<b>1.1</b>	<b>1.3</b>	<b>1.4</b>
<b>Leverage (x)</b>	<b>9.4</b>	<b>9.1</b>	<b>8.9</b>	<b>8.7</b>	<b>8.4</b>
<b>RoE</b>	<b>9.4</b>	<b>10.6</b>	<b>9.8</b>	<b>11.5</b>	<b>12.2</b>
<b>Adj. RoA</b>	<b>1.0</b>	<b>1.2</b>	<b>1.1</b>	<b>1.3</b>	<b>1.4</b>
<b>Adj. RoE</b>	<b>9.4</b>	<b>10.6</b>	<b>9.8</b>	<b>11.5</b>	<b>12.2</b>

Source: Company, LKP Research

**Exhibit 5: Balance Sheet Ratios**

Y/E Mar	FY20	FY21	FY22E	FY23E	FY24E
<i>Credit / Deposit Ratio</i>	83.1	81.2	81.1	81.2	81.4
<i>Incremental C/D Ratio</i>	52.6	60.2	80.7	81.8	83.5
<i>Investment Deposit Ratio</i>	22.3	21.2	21.2	21.2	21.0
<i>Dom. SLR Investment / Deposits</i>	21.9	21.0	20.9	21.0	20.8
<i>CASA Ratio</i>	25.0	29.1	29.2	29.2	29.2

Source: Company, LKP Research

**Exhibit 6: Credit Quality**

Y/E Mar	FY20	FY21	FY22E	FY23E	FY24E
<b><i>Slippage Ratio</i></b>	<b>3.4</b>	<b>3.3</b>	<b>3.0</b>	<b>2.5</b>	<b>2.2</b>
Gross NPA (Cl Bal)	14,134	18,932	19,991	20,654	21,206
<b><i>Gross NPAs Ratio (%)</i></b>	<b>4.1</b>	<b>5.1</b>	<b>5.1</b>	<b>4.9</b>	<b>4.5</b>
<b><i>PCR (%)</i></b>	<b>44.9</b>	<b>43.2</b>	<b>43.8</b>	<b>43.7</b>	<b>43.4</b>
Net NPA (Cl. Bal.)	7,785	10,752	11,226	11,637	12,007
<b><i>Net NPAs Ratio (%)</i></b>	<b>2.3</b>	<b>3.0</b>	<b>2.9</b>	<b>2.7</b>	<b>2.6</b>
Total Impaired Loans	14,134	18,932	19,991	20,654	21,206
<b><i>Impaired Loan as % of Loan / AUM</i></b>	<b>4.2</b>	<b>5.2</b>	<b>5.1</b>	<b>4.8</b>	<b>4.5</b>
Total Risk Reserves	6,349	8,180	8,765	9,017	9,198
<b><i>Total Risk As % of Loan Book</i></b>	<b>1.9</b>	<b>2.3</b>	<b>2.2</b>	<b>2.1</b>	<b>2.0</b>

Source: Company, LKP Research



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