JM FINANCIAL

City Union Bank | BUY

Another healthy operating quarter

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CUBK reported a steady operating performance in 4QFY18 with net profit up 18% YoY at INR 1.52bn. Loan growth was healthy at 17% YoY, while margin declined slightly (although lower than management guidance) and was 11bps lower than the peak reached in 1QFY18. Going forward, management continues to guide for a contraction in margins in FY19E. Management expects that margin compression, along with lower treasury profits (from the high base of FY18), will keep PPoP growth muted in FY19E. On the flip side, asset quality remains in fine fettle for CUBK: GNPLs were steady at 3% (with PCR of 45%), and net stress on the loan book remains comfortable at 2.5% (Exhibit 5). We believe that a reduction in credit costs going forward will help CUBK maintain RoAs of 1.6% over FY18-20E even as margins come off, with PAT CAGR of 16% over this period. We have cut our earnings estimates by 2% / 1% in FY19E / FY20E, with no material change to fully adjusted book value. We value CUBK at 2.6x FY20E fully adjusted BVPS to arrive at our TP of INR 200/sh. Maintain BUY.

- **Healthy operating quarter:** Loan growth was healthy at 17% YoY driven by a pick-up in key segments: like MSME (+34% YoY), wholesale traders (+25% YoY) and retail (+22% YoY). Management guides for 18-20% loan growth in FY19E. The bank has not availed of the RBI dispensation to spread MTM treasury losses. Opex growth remained muted in 4QFY18, as rising interest rates had a favourable impact on gratuity provisions. As a result, PPoP growth was healthy for 4QFY18 at 19% YoY. CUBK plans to add 50-75 branches in FY19E. The bank was impacted by cyber-attacks in 3QFY18 and these have been provided for: CUBK provided INR 137mn over 3QFY18 and 4QFY18 for these. It has also raised an insurance claim for INR 250mn for the same.
- **Margins continue to hold:** NIM for 4QFY18 was at 4.36% (11bps below peak levels of 1QFY18). Management expects NIMs to reduce marginally in FY19E as yields remain under pressure in the MSME segment and retail FDs get re-priced at higher rates. CUBK closed FY18 with 10-year high CD ratio of 85% and we believe that this has helped it sustain NIM. We factor in 12bps compression in our calculated NIMs for CUBK over FY19-20E in our estimates. Lower NIMs and lower treasury profits are expects to keep PPoP growth muted in FY19E, but we expect this to be offset by a reduction in credit costs as asset quality remains in fine fettle.
- **Credit costs to trend lower:** Asset quality remained in good health for CUBK, with net unprovided stress (net NPA + other stress) now at 2.5% of loans. Moreover, SMA2 loans above INR 50mn is comfortable at ~1.5%. CUBK has not restructured any account in FY18 and not sold down any account to ARCs over the last 2 years. Management expects slippage rates to come down to 1.75-2% in FY19E as a result of a reduction in its legacy stress pool. We expect average credit cost of ~1% over FY19-20E with PCR improving to 51% by FY20E. We expect CUBK to sustain RoA of ~1.6% over FY19-20E as a result of containment of its credit cost. Strong recoveries from technically written-off accounts may pose upside risks to our earnings estimates.

Recommendation and Price Target	
Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	200
Upside/(Downside)	9.1%
Previous Price Target	200
Change	NA

Key Data – CUBK IN	
Current Market Price	INR183
Market cap (bn)	INR121.9/US$1.8
Free Float	83%
Shares in issue (mn)	601.1
Diluted share (mn)	
3-mon avg daily val (mn)	INR159.3/US$2.3
52-week range	209/147
Sensex/Nifty	34,663/10,514
INR/US$	68.3

Price Performance			
%	1M	6M	12M
Absolute	1.3	10.5	20.4
Relative*	1.2	7.4	5.3

* To the BSE Sensex

Financial Summary					(INR mn)
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Profit	4,447	5,027	5,919	6,771	8,009
Net Profit (YoY) (%)	12.6%	13.0%	17.7%	14.4%	18.3%
Assets (YoY) (%)	14.1%	10.9%	13.2%	15.3%	17.2%
ROA (%)	1.5%	1.5%	1.6%	1.6%	1.6%
ROE (%)	15.5%	15.2%	15.3%	15.3%	16.1%
EPS	7.4	8.4	8.9	10.2	12.0
EPS (YoY) (%)	12.3%	12.5%	6.5%	14.4%	18.3%
PE (x)	**24.6**	**21.9**	**20.6**	**18.0**	**15.2**
BV	51	59	63	70	80
BV (YoY) (%)	12.9%	16.4%	5.4%	12.1%	13.4%
P/BV (x)	**3.59**	**3.08**	**2.92**	**2.61**	**2.30**

Source: Company data, JM Financial. Note: Valuations as of 24/May/2018

City Union Bank 4Q18: Key quarterly trends

Exhibit 1. CUBK 4Q18 : Key quarterly trends

Earnings Table (Rs mn)	4Q'17	3Q'18	4Q'18	YoY (%)	QoQ (%)
NII	**3,106**	**3,651**	**3,679**	**18.5%**	**0.8%**
Fee based Income	582	612	680	16.8%	11.1%
Trading Profits	357	344	301	-15.7%	-12.5%
Misc Income	-1	0	0	-143.4%	-409.2%
Non-Interest income	**1,258**	**1,217**	**1,198**	**-4.8%**	**-1.5%**
Total Income	**4,364**	**4,868**	**4,878**	**11.8%**	**0.2%**
Employee Cost	778	799	768	-1.3%	-3.9%
Other Operating Expenses	1,110	1,105	1,167	5.2%	5.6%
Total Operating Expenses	1,888	1,904	1,935	2.5%	1.6%
Operating Profit	**2,476**	**2,965**	**2,943**	**18.8%**	**-0.7%**
Loan Loss Provisions	450	810	698	55.0%	-13.9%
Standard Asset Provisions	0	20	-5	NM	NM
Provisions on Investments(AFS)	0	0	0	NM	NM
Other Provisions	263	27	169	35.6%	-535.3%
Total Provisions	**713**	**857**	**862**	**20.9%**	**0.6%**
PBT	1,764	2,108	2,081	18.0%	-1.3%
Tax	475	560	560	17.9%	0.0%
PAT (Pre-Extraordinaries)	1,289	1,548	1,521	18.0%	-1.7%
Extraordinaries (Net of Tax)	0	0	0	0.0%	0.0%
Reported Profit	**1,289**	**1,548**	**1,521**	**18.0%**	**-1.7%**
Balance sheet (Rs bn)					
Deposits	301.2	313.4	328.5	9.1%	4.8%
Net Advances	238.3	256.8	278.5	16.9%	8.5%
Total Assets	**352.7**	**376.2**	**399.4**	**13.2%**	**6.2%**
Low-cost Deposits (%)	23.4%	22.3%	24.2%	0.8%	1.9%
Loan-Deposit ratio (%)	79.1%	81.9%	84.8%	5.6%	2.8%
Key Ratios					
Credit Quality					
Gross NPAs (Rs. mn.)	6,820	8,598	8,566	25.6%	-0.4%
Net NPAs (Rs. mn.)	4,083	4,478	4,748	16.3%	6.0%
Gross NPA (%)	2.83%	3.30%	3.03%	0.20%	-0.26%
Net NPA (%)	1.71%	1.74%	1.70%	-0.01%	-0.04%
Loan Loss Provisions (%)	0.80%	1.41%	1.07%	0.27%	-0.33%
Coverage Ratio (%)	40.1%	47.9%	44.6%	4.4%	-3.3%
Capital Adequacy					
Tier I (%)	15.36%	14.47%	15.79%	0.43%	1.32%
CAR (%)	15.83%	14.93%	16.22%	0.39%	1.29%
Du-pont Analysis					
NII / Assets (%)	3.55%	3.94%	3.80%	0.24%	-0.14%
Non-Interest Inc. / Assets (%)	1.44%	1.31%	1.24%	-0.20%	-0.08%
Operating Cost / Assets (%)	2.16%	2.05%	2.00%	-0.16%	-0.06%
Operating Profits / Assets (%)	2.83%	3.20%	3.04%	0.20%	-0.16%
Provisions / Assets (%)	0.81%	0.92%	0.89%	0.07%	-0.03%
ROA (%)	**1.47%**	**1.67%**	**1.57%**	**0.10%**	**-0.10%**

Source: Company, JM Financial

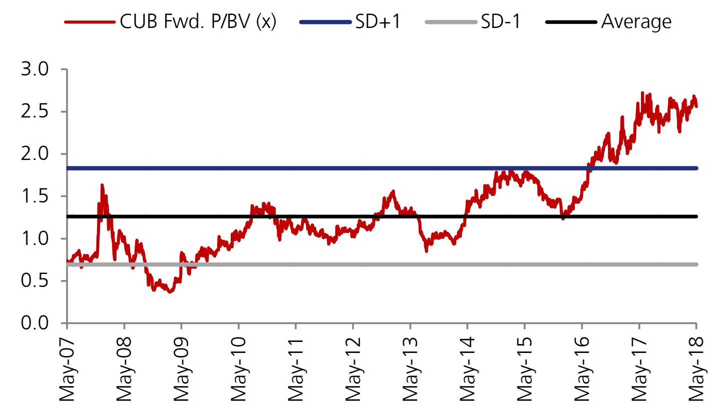
Valuation summary

Exhibit 2. CUBK: Valuation summary

Initial no of years (yrs)	10
Growth rate for the first 10 years (%)	16.4%
Payout ratio for the first 10 years (%)	6.5%
Perpetual growth rate (%)	3.9%
Perpetual payout ratio (%)	78.0%
K1	0.8
K2	13.8
Fully adjusted FY19E BVPS (Rs)	77.7
Target P/BV (x)	2.57x
Fair value (rounded off)	**200**

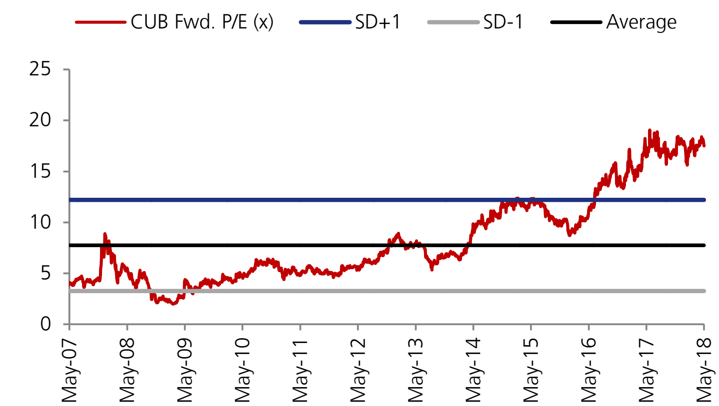
Source: Company, JM Financial

Exhibit 3. One year fwd price to book (x)



Source: Company, JM Financial

Exhibit 4. One year fwd price to earnings (x)



Source: Company, JM Financial

Exhibit 5. CUBK : Net stress on loan book

Stressed assets	INR mn	% of net loans
Net NPA	4,748	1.7%
Other stress :		
Security Receipts	3,413	1.2%
(less provision on SR)	(1,320)	-0.5%
Standard restructured	81	0.0%
Net stress (Net NPA + other unprovided stress)	**6,922**	**2.5%**

Source: Company, JM Financial

Exhibit 6. CUBK 4Q18: Deposit composition

Deposits Composition (Rs bn)	4Q'17	3Q'18	4Q'18	YoY (%)	QoQ (%)
Current	24	23	28	15.7%	21.9%
Saving	46	47	52	11.7%	9.9%
Time	231	243	249	7.9%	2.2%
Total Deposits	**301**	**313**	**329**	**9.1%**	**4.8%**
Current	8%	7%	8%	0.5%	1.2%
Saving	15%	15%	16%	0.4%	0.7%
CASA	23%	22%	24%	0.8%	1.9%
Time	77%	78%	76%	-0.8%	-1.9%
Total	**100%**	**100%**	**100%**		

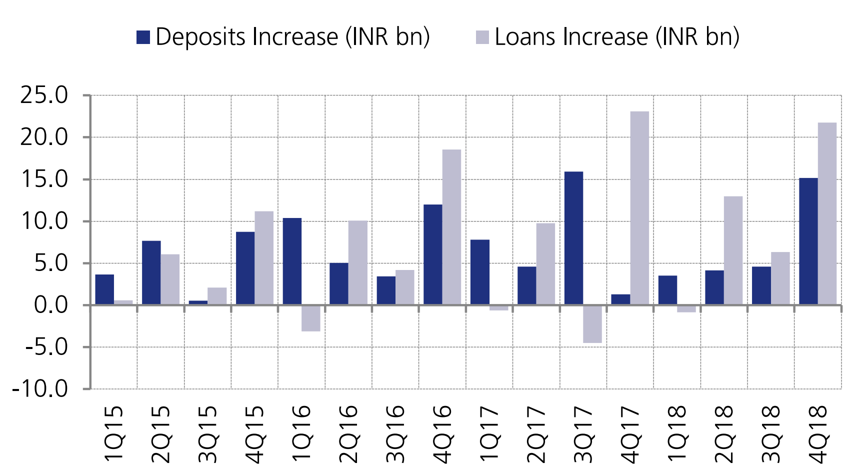
Source: Company, JM Financial

Exhibit 7. CUBK 4Q18: Loan mix and growth trends

Loan book (INR bn)	4Q'17	3Q'18	4Q'18	YoY (%)	QoQ (%)
Agriculture	**43,571**	**35,479**	**40,834**	**-6.3%**	**15.1%**
Includes Jewel Loans of	18,495	19,325	19,719	6.6%	2.0%
MSME	71,718	90,340	95,808	33.6%	6.1%
Retail traders	10,210	8,479	10,467	2.5%	23.4%
Wholesale traders	32,644	37,042	40,853	25.1%	10.3%
Large Industries	17,604	18,640	18,888	7.3%	1.3%
Commercial Real Estate	12,399	13,310	13,911	12.2%	4.5%
Loans collateralized by deposits	4,274	4,556	4,977	16.4%	9.2%
Infrastructure	1,859	1,792	1,729	-7.0%	-3.5%
NBFC	2,259	2,431	2,730	20.8%	12.3%
Others	17,876	18,687	19,478	9.0%	4.2%
Retail Loans	**26,710**	**30,135**	**32,711**	**22.5%**	**8.5%**
Other Personal Loans	7,195	9,128	10,416	44.8%	14.1%
Jewel loan (non-agri)	2,863	3,131	3,717	29.8%	18.7%
Housing Loans	16,652	17,876	18,578	11.6%	3.9%
Gross loans	**2,41,124**	**2,60,891**	**2,82,386**	**17.1%**	**8.2%**
Loan book mix (%)	**4Q'17**	**3Q'18**	**4Q'18**	**YoY (%)**	**QoQ (%)**
Agriculture	**18.1%**	**13.6%**	**14.5%**	**-3.6%**	**0.9%**
Includes Jewel Loans of	7.7%	7.4%	7.0%	-0.7%	-0.4%
MSME	29.7%	34.6%	33.9%	4.2%	-0.7%
Commercial Real Estate	4.2%	3.3%	3.7%	-0.5%	0.5%
Retail traders	13.5%	14.2%	14.5%	0.9%	0.3%
Wholesale traders	7.3%	7.1%	6.7%	-0.6%	-0.5%
Large Industries	5.1%	5.1%	4.9%	-0.2%	-0.2%
Loans collateralized by deposits	1.8%	1.7%	1.8%	0.0%	0.0%
Infrastructure	0.8%	0.7%	0.6%	-0.2%	-0.1%
NBFC	0.9%	0.9%	1.0%	0.0%	0.0%
Others	7.4%	7.2%	6.9%	-0.5%	-0.3%
Retail Loans	**11.1%**	**11.6%**	**11.6%**	**0.5%**	**0.0%**
Other Personal Loans	3.0%	3.5%	3.7%	0.7%	0.2%
Jewel loan (non-agri)	1.2%	1.2%	1.3%	0.1%	0.1%
Housing Loans	6.9%	6.9%	6.6%	-0.3%	-0.3%
Gross loans	**100%**	**100%**	**100%**		

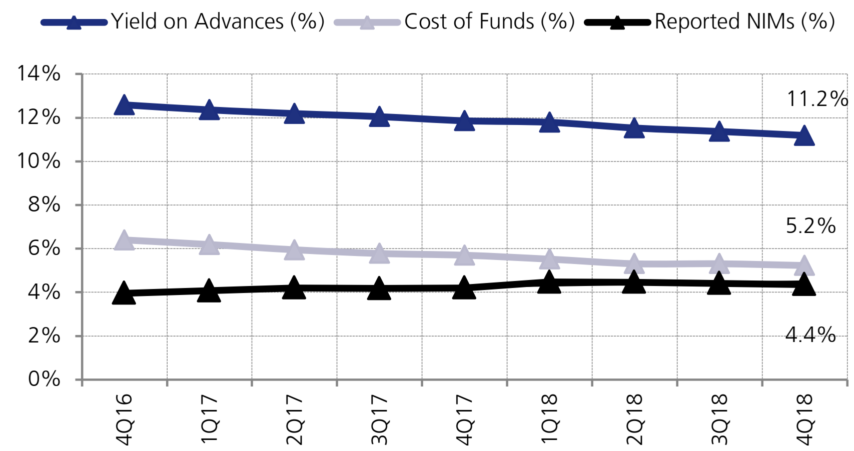
Source: Company, JM Financial

Exhibit 8. CUBK 4Q18: Trends in accretion to loans and deposits



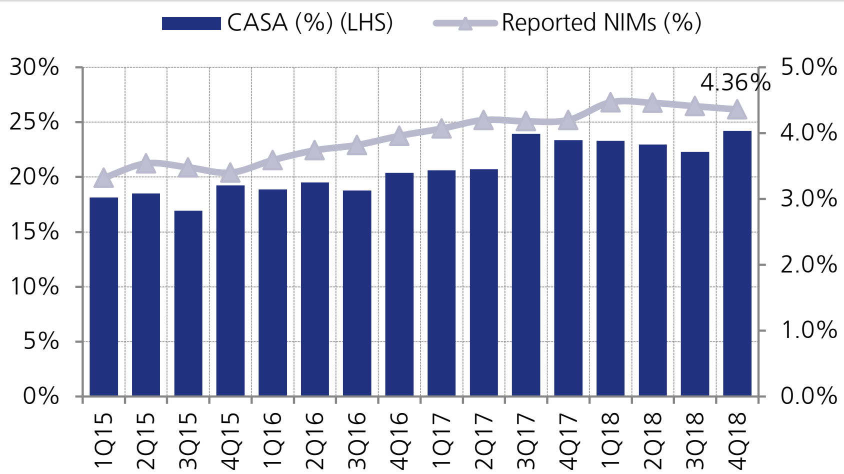
Source: Company, JM Financial

Exhibit 9. CUBK 4Q18: Yields and margins (%)



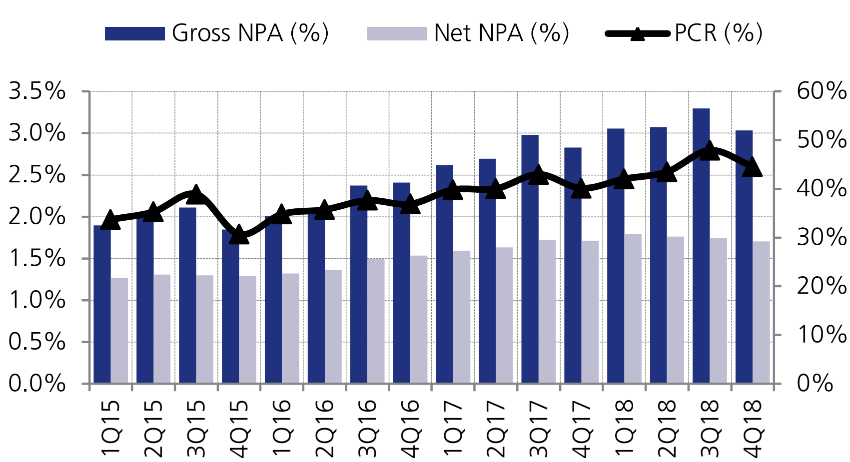
Source: Company, JM Financial

Exhibit 10. Trends in CASA and NIMs



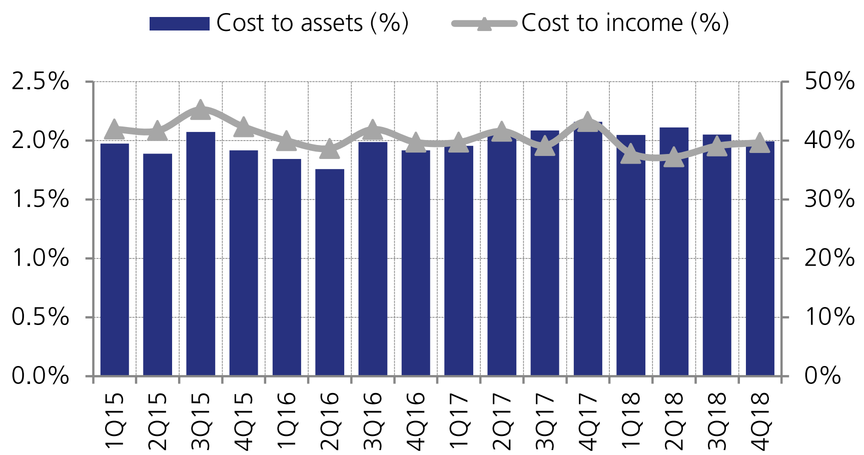
Source: Company, JM Financial

Exhibit 11. CUBK 4Q18: NPL trends and coverage (%)



Source: Company, JM Financial

Exhibit 12. CUBK 4Q18: Cost ratios (%)



Source: Company, JM Financial

Financial Tables (Standalone)

Profit & Loss (INR mn)

Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Interest Income	9,810	11,988	14,303	16,137	18,630
Profit on Investments	453	1,078	1,681	800	1,000
Exchange Income	806	978	1,184	1,421	1,705
Fee & Other Income	2,841	2,783	2,455	2,865	3,343
Non-Interest Income	**4,100**	**4,839**	**5,320**	**5,085**	**6,048**
Total Income	**13,910**	**16,826**	**19,623**	**21,222**	**24,678**
Operating Expenses	5,577	6,890	7,546	8,727	9,955
Pre-provisioning Profits	**8,333**	**9,937**	**12,077**	**12,496**	**14,724**
Loan-Loss Provisions	2,262	2,595	3,900	3,055	3,623
Provisions on Investments	0	490	0	27	27
Others Provisions	44	-75	278	264	250
Total Provisions	**2,306**	**3,010**	**4,178**	**3,346**	**3,901**
PBT	**6,027**	**6,927**	**7,899**	**9,150**	**10,823**
Tax	1,580	1,900	1,980	2,379	2,814
PAT (Pre-Extraordinaries)	**4,447**	**5,027**	**5,919**	**6,771**	**8,009**
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	**4,447**	**5,027**	**5,919**	**6,771**	**8,009**
Dividend paid	925	199	199	1,738	1,738
Retained Profits	**3,522**	**4,828**	**5,720**	**5,033**	**6,271**

Source: Company, JM Financial

Balance Sheet (INR mn)

Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Equity Capital	598	601	665	665	665
Reserves & Surplus	29,922	35,101	40,968	46,001	52,272
Deposits	2,71,581	3,01,157	3,28,526	3,76,163	4,38,229
Borrowings	6,645	5,310	17,359	21,674	27,067
Other Liabilities	9,293	10,538	11,855	16,004	21,606
Total Liabilities	**3,18,040**	**3,52,708**	**3,99,372**	**4,60,506**	**5,39,839**
Investments	68,265	70,315	78,791	86,551	1,00,828
Net Advances	2,10,569	2,38,327	2,78,528	3,28,663	3,91,109
Cash & Equivalents	26,501	28,790	26,364	28,120	32,977
Fixed Assets	2,176	2,151	2,231	2,120	1,908
Other Assets	10,530	13,126	13,458	15,051	13,017
Total Assets	**3,18,040**	**3,52,708**	**3,99,372**	**4,60,506**	**5,39,839**

Source: Company, JM Financial

Key Ratios

Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Growth (YoY) (%)					
Deposits	12.8%	10.9%	9.1%	14.5%	16.5%
Advances	17.2%	13.2%	16.9%	18.0%	19.0%
Total Assets	14.1%	10.9%	13.2%	15.3%	17.2%
NII	21.5%	22.2%	19.3%	12.8%	15.5%
Non-interest Income	1.5%	18.0%	9.9%	-4.4%	18.9%
Operating Expenses	7.5%	23.5%	9.5%	15.6%	14.1%
Operating Profits	20.3%	19.2%	21.5%	3.5%	17.8%
Core Operating profit	24.6%	12.4%	17.3%	12.5%	17.3%
Provisions	26.3%	30.5%	38.8%	-19.9%	16.6%
Reported PAT	12.6%	13.0%	17.7%	14.4%	18.3%
Yields / Margins (%)					
Interest Spread	2.72%	3.12%	3.39%	3.28%	3.18%
NIM	3.42%	3.73%	3.97%	3.90%	3.85%
Profitability (%)					
Non-IR to Income	29.5%	28.8%	27.1%	24.0%	24.5%
Cost to Income	40.1%	40.9%	38.5%	41.1%	40.3%
ROA	1.49%	1.50%	1.57%	1.57%	1.60%
ROE	15.5%	15.2%	15.3%	15.3%	16.1%
Assets Quality (%)					
Slippages	2.42%	2.31%	2.45%	2.00%	2.00%
Gross NPA	2.41%	2.83%	3.03%	2.67%	2.59%
Net NPAs	1.53%	1.71%	1.70%	1.40%	1.29%
Provision Coverage	36.9%	40.1%	44.6%	48.1%	50.8%
Specific LLP	1.05%	1.12%	1.50%	1.00%	1.00%
Net NPAs / Networth	10.6%	11.4%	11.4%	9.9%	9.5%
Capital Adequacy (%)					
Tier I	15.09%	15.35%	15.81%	15.15%	14.46%
CAR	15.58%	15.83%	16.23%	15.51%	14.76%

Source: Company, JM Financial

Dupont Analysis

Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
NII / Assets	3.29%	3.57%	3.80%	3.75%	3.72%
Other Income / Assets	1.37%	1.44%	1.41%	1.18%	1.21%
Total Income / Assets	4.66%	5.02%	5.22%	4.94%	4.93%
Cost / Assets	1.87%	2.05%	2.01%	2.03%	1.99%
PBP / Assets	2.79%	2.96%	3.21%	2.91%	2.94%
Provisions / Assets	0.77%	0.90%	1.11%	0.78%	0.78%
PBT / Assets	2.02%	2.07%	2.10%	2.13%	2.16%
Tax rate	26.2%	27.4%	25.1%	26.0%	26.0%
ROA	1.49%	1.50%	1.57%	1.57%	1.60%
RoRWAs	2.43%	2.33%	2.41%	2.39%	2.39%
Leverage	10.4	9.9	9.6	9.9	10.2
ROE	15.5%	15.2%	15.3%	15.3%	16.1%

Source: Company, JM Financial

Valuations

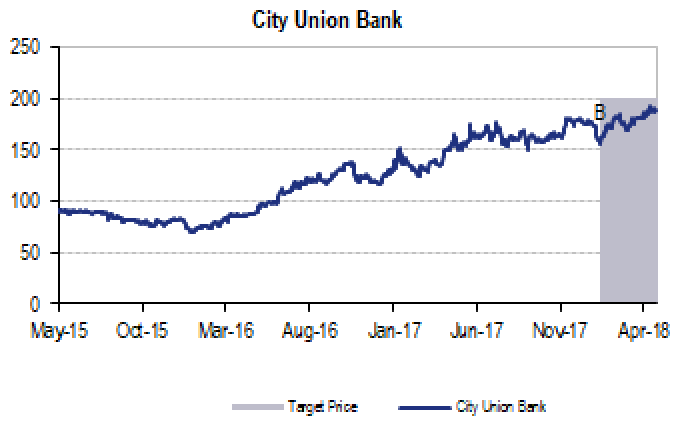
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Shares in Issue	598.2	601.1	664.7	664.7	664.7
EPS (INR)	7.4	8.4	8.9	10.2	12.0
EPS (YoY) (%)	12.3%	12.5%	6.5%	14.4%	18.3%
PER (x)	24.6	21.9	20.6	18.0	15.2
BV (INR)	51	59	63	70	80
BV (YoY) (%)	12.9%	16.4%	5.4%	12.1%	13.4%
ABV (INR)	49	57	61	69	78
ABV (YoY) (%)	12.7%	16.5%	6.1%	13.1%	14.0%
P/BV (x)	3.59	3.08	2.92	2.61	2.30
P/ABV (x)	3.73	3.20	3.02	2.67	2.34
DPS (INR)	1.5	0.3	0.3	2.6	2.6
Div. yield (%)	0.8%	0.2%	0.2%	1.4%	1.4%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
7-Feb-18	Buy	200	

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081
Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.
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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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