

## Smooth journey continues

**We retain Hold on CUBK with TP at Rs160 (valued at 2.2x FY20E ABV). Q2'19 revenue beat estimates on strong margin performance; PAT though was as per expectations. Loan growth remains healthy (consecutive fourth quarter of 17%+ YoY growth); asset quality intact with coverage (incl. tech w/off) healthy at 65%; capital position remains strong (CAR / Tier-I at 15.1% / 14.7% respectively). We like CUBK for its business model and superior return ratios. Valuations at 2.4x FY20E ABV, however limit near term upside.**

- **Q2'19 results as expected:** NII beat our estimates and came in at Rs4bn growing by a healthy 6.2% QoQ owing to improvement in NIM (calc) by 16bps to 3.88%. Overall credit grew by 17.5% to Rs294bn. Other income included PSLC income of Rs78.2mn. Operating profit at Rs2.96bn declined 7.5% YoY owing to lower treasury gains YoY and a slight bump up in operating expenses. Treasury gains came in Rs213mn vs Rs646mn in Q2FY18. Slippages as expected came in at Rs1.36bn and the GNPA ratio improved by 17bps to 2.85% while NNPA at 1.69% was unchanged. Owing to better asset quality, provisions were lower than expected at Rs680mn (incl. Rs 470mn for NPA and Rs80mn on security receipts). Consequently PAT was in-line at Rs1.7bn.
- **Asset quality intact; paper account may slip next quarter:** Q2FY19 slippages at Rs1.36bn (185bps of loans) were in-line with our estimates of Rs1.4bn. Two exposures from the steel and oil sectors amounting to Rs250mn combined, mainly contributed to slippages and the remaining was from smaller accounts (<Rs100mn). In Q1FY19 the management was monitoring two large accounts (paper mill and education institution) with combined exposure of Rs1.5bn. During Q2FY19 the education account was upgraded; paper exposure of Rs700-750mn might slip in the next quarter. Management, however have retained their slippage guidance at ~175-200bps for FY19E (vs. 206bps for FY18). Restructured portfolio remains negligible at 0.02% of loans; outstanding security receipts (SR) is at Rs3.3bn. The bank carries Rs1.5bn (45.6%) provision against these SRs; management have guided at raising coverage to 60% thereon. We have left our slippage estimates unchanged; revised credit costs higher given NPA ageing.
- **Positive surprise on margin; growth trajectory to continue:** Q2'19 NIM (rep.) at 4.32% improved by 8bps QoQ following positive impact of ~8bps due to reprising of prior period deposits (from the ~3 year bucket). The bank has revised its MCLR by 25bps in August, 2018 which will aid in cushioning the margin. While CUBK has a favourable ALM in the less than 1-year bucket, the same is disadvantageous in 1-3year bucket; we thus foresee 10bps contraction in the NIM over FY19-20E. Q2'19 loans grew 17.5% YoY led by strong traction in retail (+28.6% YoY), MSME (+17.5% YoY) and retail trading (+21.7% YoY). Management has guided for 18-20% growth in loans for FY19E; we are building in a 19% CAGR in loans over FY18-20E. We expect a revenue / PPOP / PAT CAGR of 13.7% / 10% / 19.6% over FY18-20E.
- **Valuation, view and key risks:** We have revised our margin and credit cost estimate upwards over FY19E/FY20E. We like CUBK for its consistency in earnings, superior return ratios (best among regional peers) and healthy capital position. These aspects have also contributed to a premium valuation for CUBK over its peers. We suggest accumulating CUBK at lower levels. Retain HOLD with TP Rs160. Key risks: lower growth / higher than expected margin compression.

(Rs mn)	Q2FY19	Q2FY18	% YoY	Q1FY19	% QoQ	Q2FY19E	% Var
<b>Net Interest Income</b>	<b>3,980</b>	<b>3,549</b>	<b>12.2</b>	<b>3,748</b>	<b>6.2</b>	<b>3,788</b>	<b>5.1</b>
Operating Profit	2,959	3,201	(7.5)	2,994	(1.2)	3,056	(3.2)
<b>Reported PAT</b>	<b>1,680</b>	<b>1,448</b>	<b>16.0</b>	<b>1,616</b>	<b>3.9</b>	<b>1,684</b>	<b>(0.2)</b>
NIM (calc) %	3.88	3.91	(3bps)	3.72	16bps	3.66	22bps
GNPA	8,479	7,804	8.6	8,511	(0.4)	8,848	(4.2)
NNPA	4,978	4,410	12.9	4,735	5.1	4,867	2.3
<b>PCR (%) reported</b>	<b>65.0</b>	<b>63.0</b>	<b>200bps</b>	<b>65.0</b>	<b>0</b>	<b>NA</b>	<b>NA</b>

Source: Company, Centrum Research

Y/E Mar (Rs mn)	Net income#	PPOP	Reported PAT	YoY (%)	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	RoA (%)	RoE (%)
FY16	13,910	8,333	4,447	15.8	7.4	10.3	45.6	1.7	1.5	15.5
FY17	16,827	9,937	5,028	13.1	8.4	12.7	52.6	2.0	1.5	15.2
FY18	19,624	12,078	5,920	17.7	8.9	16.7	55.5	2.7	1.6	15.3
FY19E	22,031	13,073	7,186	21.4	9.8	17.6	59.7	2.9	1.7	15.9
FY20E	24,881	14,609	8,462	17.8	11.6	14.6	70.8	2.4	1.7	16.1

Source: Company, Centrum Research Estimates #denotes NII + other income. FY16-19E YTD have been valued on average market cap basis

In the interest of timeliness, this document is not edited

**Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet**

Target Price	Rs160	Key Data
CMP*	Rs169	Bloomberg Code CUBK IN
Downside	5.4%	Curr Shares O/S (mn) 664.7
Previous Target	Rs165	Diluted Shares O/S(mn) 664.7
Previous Rating	Hold	Mkt Cap (Rs bn/USD bn) 123.9/1.7
<b>Price Performance (%)*</b>		52 Wk H / L (Rs) 207.2/134.1
	<b>1M 6M 1Yr</b>	5 Year H / L (Rs) 207.2/37.7
CUBK IN	(1.6) 0.8 16.4	Daily Vol. (3M NSE Avg.) 815619.9
Nifty	(4.1) (1.5) 1.2	

\*as on 2 November 2018; Source: Bloomberg, Centrum Research

### Shareholding pattern (%)\*

	Sep-18	Jun-18	Mar-18	Dec-17
Promoter	0.0	0.0	0.0	0.0
FIs	27.3	28.3	30.4	31.5
DIs	23.9	22.5	20.3	19.0
Others	48.8	49.2	49.3	49.5

Source: BSE, \*as on 2 November 2018

### Earnings Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
NII + Oth. Inc	22,031	20,909	5.4	25,393	23,530	7.9
PPOP	13,073	12,165	7.5	14,609	13,755	6.2
Rep. PAT	7,186	6,936	3.6	8,462	8,094	4.5

### Centrum vs. Bloomberg Consensus\*

Particulars (Rs mn)	FY19E			FY20E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
NII + Oth. Inc	22031	21553	2.2	25393	24892	2.0
PPOP	13073	12952	0.9	14609	15059	(3.0)
Rep. PAT	7186	6832	5.2	8462	8160	3.7

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
18	0	4	193	160	(17.1)

\*as on 2 November 2018; Source: Bloomberg, Centrum Research Estimates

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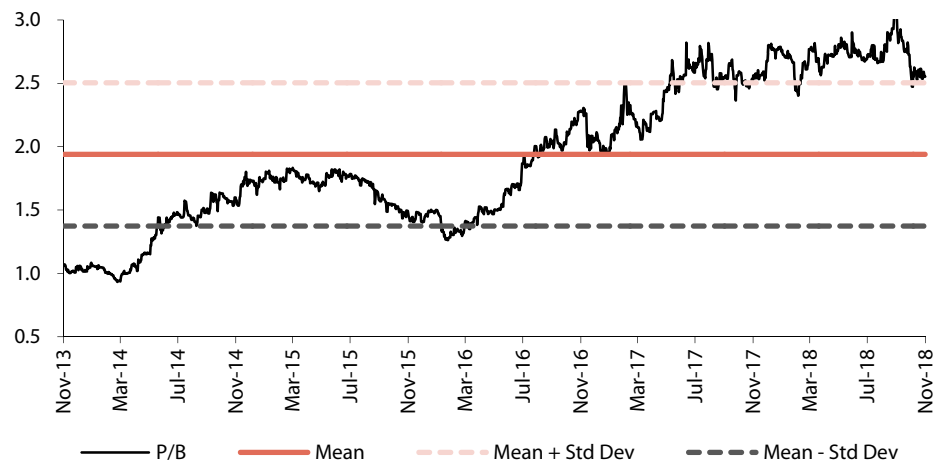
## Sensitivity analysis and peer comparison

**Exhibit 1: Sensitivity Analysis – impact of change in NIM and credit cost on FY19E PBT**

%	Credit cost				
	+ 10bps	+ 20bps	' Current levels	- 10bps	- 20bps
- 5bps	(5.2)	(8.3)	(2.1)	1.0	4.1
- 10bps	(7.3)	(10.4)	(4.2)	(1.1)	2.0
<b>NIM</b> Current levels	(3.1)	(6.2)	-	3.1	6.2
+ 5bps	(1.0)	(4.1)	2.1	5.2	8.3
+ 10bps	1.1	(2.0)	4.2	7.3	7.3

Source: Centrum Research Estimates

**Exhibit 2: Rolling forward P/ABV chart**



Source: Bloomberg, Company, Centrum Research Estimates

**Exhibit 3: Comparative Valuations**

	Mkt Cap (Rs mn)	CAGR (FY18-FY20E) %			PE (x)			ROA (%)			RoE (%)			P/BVPS (x)		
		NII + Oth inc	PPOP	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
<b>CUBK*</b>	<b>1,23,872</b>	<b>12.6</b>	<b>10.0</b>	<b>19.6</b>	<b>16.7</b>	<b>17.6</b>	<b>14.6</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>	<b>15.3</b>	<b>15.9</b>	<b>16.1</b>	<b>2.4</b>	<b>2.6</b>	<b>2.2</b>
DCB Bank*	49,250	16.2	21.4	31.4	23.3	17.0	11.6	0.9	0.9	1.1	10.9	11.5	13.9	2.2	1.9	1.5
Karnataka Bk*	29,462	10.7	10.5	52.9	13.3	6.0	3.9	0.5	0.7	0.9	6.2	9.6	12.6	0.9	0.6	0.5
Federal Bank	1,63,296	17.6	20.7	24.2	19.8	14.1	10.3	0.8	0.8	0.9	9.8	9.4	11.6	1.7	1.3	1.1
Karur Vysya	63,153	12.0	6.0	50.9	21.3	16.6	7.0	0.6	0.6	1.1	8.1	6.8	13.0	1.5	1.1	0.9
South Indian Bk	26,602	9.6	5.8	24.4	15.1	12.1	5.1	0.4	0.4	0.5	7.2	5.9	9.4	1.1	0.7	0.5

Source: Bloomberg consensus, \*Centrum Research Estimates. FY18-19E have been valued on average market cap basis

#### Exhibit 4: Quarterly Financials

(Rs mn)	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
<b>Income statement</b>								
Interest earned	8,110	7,999	8,255	8,409	8,654	8,706	8,895	9,265
Interest expended	5,040	4,893	4,832	4,860	5,002	5,027	5,147	5,285
<b>Net interest income</b>	<b>3,070</b>	<b>3,106</b>	<b>3,424</b>	<b>3,549</b>	<b>3,651</b>	<b>3,679</b>	<b>3,748</b>	<b>3,980</b>
Non-interest income	1,428	1,259	1,353	1,552	1,217	1,198	1,291	1,186
<b>Total income</b>	<b>4,498</b>	<b>4,365</b>	<b>4,777</b>	<b>5,101</b>	<b>4,868</b>	<b>4,878</b>	<b>5,039</b>	5,166
Operating expenses	1,762	1,888	1,807	1,900	1,904	1,935	2,045	2,206
<b>Pre-provision profit</b>	<b>2,736</b>	<b>2,477</b>	<b>2,970</b>	<b>3,201</b>	<b>2,965</b>	<b>2,943</b>	<b>2,994</b>	<b>2,959</b>
Provisions	920	713	1,166	1,293	857	862	778	680
<b>Profit before Tax</b>	<b>1,816</b>	<b>1,764</b>	<b>1,803</b>	<b>1,908</b>	<b>2,108</b>	<b>2,081</b>	<b>2,216</b>	2,280
Tax	550	475	400	460	560	560	600	600
<b>Reported PAT</b>	<b>1,266</b>	<b>1,289</b>	<b>1,403</b>	<b>1,448</b>	<b>1,548</b>	<b>1,521</b>	<b>1,616</b>	<b>1,680</b>
<b>Balance sheet items</b>								
Deposits	2,99,857	3,01,157	3,04,683	3,08,816	3,13,870	3,28,526	3,35,974	3,45,340
Investments	85,248	70,315	73,998	75,147	76,312	80,150	82,098	80,221
Advances	2,18,007	2,38,327	2,40,580	2,50,450	2,60,891	2,78,528	2,82,151	2,94,251
<b>Ratios</b>								
<b>Growth YoY (%)</b>								
NII	21.4	17.4	22.3	17.8	18.9	18.5	9.5	12.2
Non-interest income	38.2	17.4	21.8	49.0	(14.8)	(4.8)	(4.6)	(23.6)
Opex	18.0	27.8	16.3	12.7	8.0	2.5	13.1	16.1
PPOP	32.2	10.6	26.0	35.2	8.4	18.8	0.8	(7.5)
PAT	12.0	14.9	13.6	17.0	22.3	18.0	15.2	16.0
Loans	12.5	13.2	13.4	14.0	19.7	16.9	17.3	17.5
Deposits	15.5	10.9	9.1	8.8	4.7	9.1	10.3	11.8
<b>Ratios (%)</b>								
Yield on assets	10.5	10.0	10.2	10.2	10.1	9.8	9.6	9.8
Cost of funds	6.9	6.4	6.3	6.2	6.3	6.0	5.9	6.0
Spread	3.6	3.6	3.9	4.0	3.9	3.7	3.7	3.9
NIM	3.6	3.6	3.9	3.9	4.0	3.8	3.7	3.9
CASA ratio	23.9	23.4	23.3	23.0	22.3	24.2	23.9	23.6
<b>Key drivers (%)</b>								
Cost-income	39.2	43.2	37.8	37.3	39.1	39.7	40.6	42.7
GNPA	3.0	2.8	3.1	3.1	3.3	3.0	3.0	2.9
NNPA	1.7	1.7	1.8	1.8	1.7	1.7	1.7	1.7
Provision coverage	43.0	40.1	42.0	43.5	47.9	44.6	44.4	41.3
Tier I CAR	14.4	15.4	15.4	14.9	14.5	15.8	15.6	14.7
Tier II CAR	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4
RoA	1.5	1.5	1.6	1.6	1.7	1.6	1.6	1.6
RoE	15.1	14.7	15.4	15.3	15.8	14.9	15.2	15.3

Source: Company, Centrum Research

## Financials

### Exhibit 5: Income Statement

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Interest Income	29,442	31,738	34,024	39,469	45,920
Interest Expense	19,632	19,750	19,721	23,151	27,425
<b>Net Interest Income</b>	<b>9,810</b>	<b>11,988</b>	<b>14,303</b>	<b>16,319</b>	<b>18,495</b>
Non-Interest Income	4,100	4,839	<b>5,321</b>	<b>5,712</b>	<b>6,385</b>
<b>Total Net Income</b>	<b>13,910</b>	<b>16,827</b>	<b>19,624</b>	<b>22,031</b>	<b>24,881</b>
<b>Total Operating Expenses</b>	<b>5,577</b>	<b>6,890</b>	<b>7,546</b>	<b>8,958</b>	<b>10,272</b>
Employee Expenses	2,132	2,981	3,159	3,812	4,533
Other Operating Expenses	3,446	3,908	4,388	5,145	5,739
<b>Pre-provision Profit</b>	<b>8,333</b>	<b>9,937</b>	<b>12,078</b>	<b>13,073</b>	<b>14,609</b>
<b>Provisions &amp; Contingencies</b>	<b>2,306</b>	<b>3,010</b>	<b>4,178</b>	<b>3,221</b>	<b>3,008</b>
<b>Profit Before Tax</b>	<b>6,027</b>	<b>6,928</b>	<b>7,900</b>	<b>9,852</b>	<b>11,601</b>
Taxes	1,580	1,900	1,980	2,666	3,140
<b>Profit after tax</b>	<b>4,447</b>	<b>5,028</b>	<b>5,920</b>	<b>7,186</b>	<b>8,462</b>

Source: Company, Centrum Research Estimates

### Exhibit 6: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Cash and balance with RBI	14,126	14,842	18,618	17,957	18,654
Inter-bank borrowings	12,375	13,948	7,746	8,702	10,191
Loans & Advances	2,10,569	2,38,327	2,78,528	3,30,707	3,95,228
Investments	68,265	70,315	78,791	81,586	90,462
<b>Total Int Earning Assets</b>	<b>3,05,334</b>	<b>3,37,431</b>	<b>3,83,683</b>	<b>4,38,952</b>	<b>5,14,534</b>
Fixed Assets	2,176	2,151	2,231	2,352	2,346
Other Assets	10,530	13,126	13,458	9,631	10,105
<b>Total Assets</b>	<b>3,18,040</b>	<b>3,52,708</b>	<b>3,99,372</b>	<b>4,50,935</b>	<b>5,26,985</b>
<b>Deposits</b>	<b>2,71,581</b>	<b>3,01,157</b>	<b>3,28,526</b>	<b>3,69,061</b>	<b>4,32,198</b>
Other Int Bearing Liabilities	6,645	5,310	17,359	15,313	13,881
<b>Interest Bearing Liabilities</b>	<b>2,78,227</b>	<b>3,06,467</b>	<b>3,45,885</b>	<b>3,84,374</b>	<b>4,46,079</b>
Other non int bearing Liabilities	9,293	10,538	11,855	18,007	24,154
Total Liabilities	2,87,520	3,17,006	3,57,740	4,02,381	4,70,233
Equity	30,520	35,702	41,632	48,554	56,752
<b>Total Liabilities</b>	<b>3,18,040</b>	<b>3,52,708</b>	<b>3,99,372</b>	<b>4,50,935</b>	<b>5,26,985</b>

Source: Company, Centrum Research Estimates

### Exhibit 7: DuPont analysis

(% of avg assets)	FY16	FY17	FY18	FY19E	FY20E
Interest income	9.9	9.5	9.0	9.3	9.4
Interest expenses	6.6	5.9	5.2	5.4	5.6
<b>NII</b>	<b>3.3</b>	<b>3.6</b>	<b>3.8</b>	<b>3.8</b>	<b>3.8</b>
Other income	1.4	1.4	1.4	1.3	1.3
<b>Total income</b>	<b>4.7</b>	<b>5.0</b>	<b>5.2</b>	<b>5.2</b>	<b>5.1</b>
Operating expenses	1.9	2.1	2.0	2.1	2.1
<b>PPOP</b>	<b>2.8</b>	<b>3.0</b>	<b>3.2</b>	<b>3.1</b>	<b>3.0</b>
Provisions	0.8	0.9	1.1	0.8	0.6
<b>PBT</b>	<b>2.0</b>	<b>2.1</b>	<b>2.1</b>	<b>2.3</b>	<b>2.4</b>
Tax	0.5	0.6	0.5	0.6	0.6
<b>RoA</b>	<b>1.5</b>	<b>1.5</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>
Leverage	10.4	9.9	9.6	9.3	9.3
<b>RoE</b>	<b>15.5</b>	<b>15.2</b>	<b>15.3</b>	<b>15.9</b>	<b>16.1</b>

Source: Company, Centrum Research Estimates

### Exhibit 8: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
<b>B/S Structure Ratios (%)</b>					
CD Ratio	77.5	79.1	84.8	89.6	91.4
Incremental CD Ratio	100.3	93.9	146.9	128.7	102.2
CASA Ratio	20.4	23.4	24.2	24.3	24.8
<b>Growth Ratios (%)</b>					
Loans	17.2	13.2	16.9	18.7	19.5
Deposits	12.8	10.9	9.1	12.3	17.1
NII	21.5	22.2	19.3	14.1	13.3
Opex	7.5	23.5	9.5	18.7	14.7
PPOP	20.3	19.3	21.5	8.2	11.7
Provisions	26.3	30.5	38.8	(22.9)	(6.6)
PAT	15.8	13.1	17.7	21.4	17.8
<b>Operating Ratios (%)</b>					
Yield on funds	10.3	9.9	9.4	9.6	9.6
Cost of funds	6.9	6.1	5.5	5.6	5.8
NIM	3.4	3.7	4.0	4.0	3.9
Non-int inc / Total income	29.5	28.8	27.1	25.9	25.7
Fee to avg assets	0.1	0.1	0.1	0.2	0.2
Cost / Income	40.1	40.9	38.5	40.7	41.3
Opex / Avg assets	1.8	2.0	1.9	2.0	1.9
Provisioning cost (bps)	0.77	0.90	1.11	0.76	0.62
Effective tax rate (%)	26.2	27.4	25.1	27.1	27.1
RoA	1.5	1.5	1.6	1.7	1.7
RoE	15.5	15.2	15.3	15.9	16.1
<b>Credit Quality Ratios (%)</b>					
Gross NPA	2.4	2.9	3.1	2.8	2.4
Net NPA	1.5	1.7	1.7	1.5	1.3
Slippage rate to op advances	2.2	2.1	2.2	1.8	1.5
NPA coverage ratio(calc)	36.5	39.6	44.0	46.3	48.0
<b>Capital Adequacy Ratios (%)</b>					
Total CAR	15.6	15.8	16.2	15.4	15.1
Tier I	15.1	15.4	15.8	15.1	14.8
Tier II	0.5	0.5	0.4	0.3	0.3
Assets/equity (x)	10.4	9.9	9.6	9.3	9.3
<b>Per Share (Rs)</b>					
BVPS	51.0	59.4	62.6	66.4	77.6
Adjusted BVPS	45.6	52.6	55.5	59.7	70.8
EPS - wt avg	7.4	8.4	8.9	9.8	11.6
<b>Valuations Ratios</b>					
Price/BV (x)	1.5	1.8	2.4	2.6	2.2
Price/Adj. BV (x)	1.7	2.0	2.7	2.9	2.4
P/E (x)	10.3	12.7	16.7	17.6	14.6

Source: Company, Centrum Research Estimates. FY16-19E YTD have been valued on average market cap basis

## Appendix A

### Disclaimer

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### City Union Bank price chart



Source: Bloomberg



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Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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