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Stock Update

City Union Bank

A strong franchise, at reasonable valuations

Banks & Finance	Sharekhan code: CUB	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 151**	
Price Target: **Rs. 180**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

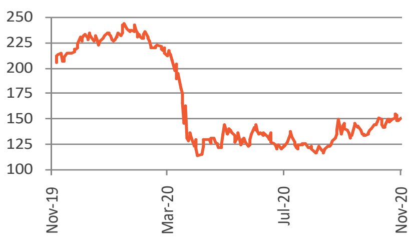
Company details

Market cap:	Rs. 11,223 cr
52-week high/low:	Rs. 249/110
NSE volume: (No of shares)	24.1 lakh
BSE code:	532210
NSE code:	CUB
Free float: (No of shares)	73.8 cr

Shareholding (%)

Promoters	-
FII	19.8
DII	27.5
Others	52.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.1	23.0	4.7	-27.6
Relative to Sensex	3.7	17.7	-13.2	-26.9

Sharekhan Research, Bloomberg

Summary

- City Union Bank (CUBK) posted in-line with expectations results; asset quality was largely stable with improving PCR. Margin also improved on a sequential basis.
- Asset quality improved on a sequential basis, with GNPA at 3.44% and NNPA at 1.81% for H1FY2021, down 65 bps/48 bps from FY2020. Moreover, PCR improved by 200 bps q-o-q to reach 70%.
- CUBK's management commentary was encouraging with management indicating better pickup in business volumes and indicated growth to return in Q4 (from Q1FY2022 guided earlier).
- CUBK currently trades at 1.8x/1.5x its FY2022E/FY2023E book value, which we believe is reasonable; We recommend Buy on the stock with a PT of Rs. 180.

City Union Bank (CUBK) posted in-line with expectations results. Asset quality was largely stable with improving PCR. Margin also improved on a sequential basis. The bank indicated that collections efficiency (CE) was improving, and total repayment for September stood at 90%. Operational performance came in line, with NII growth of Rs. 475.14 crore, up 15% y-o-y, with PAT at Rs. 157 crore, down y-o-y. Asset quality improved on a sequential basis, with GNPA at 3.44% and NNPA at 1.81% for H1FY2021, down 65 bps/48 bps from FY2020. Moreover, PCR improved by 200 bps q-o-q to reach 70%. CUBK's management commentary was encouraging with management indicating better pickup in business volumes and indicated growth to return in Q4 (from Q1FY2022 guided earlier) and asset-quality stress easing out. We prefer a constructive medium to long-term view on the bank, as we build upon our expectation that the credit quality cycle will normalise in the next few years and CUBK would likely be a key beneficiary of this reversal. That said, with credit guarantee and restructuring of loans underway, slippages or earnings visibility for the near term is likely to be murky. However, CUBK has a niche franchise with a proven history of conservative lending, which supports our positive outlook. CUBK is comfortably placed on the liabilities side, with minimal reliance on corporate bulk deposits (only 11% of total deposits are above Rs. 2 crore). We expect NIM to be stable for FY2021E, as the effect of deposit rate cuts flows through when deposits mature and are re-priced at a lower rate, which will help offset slower credit growth. CUBK has a quality franchise and a conservative lending approach, which differentiates it from several similar-size peers. We believe these attributes still hold strong. A diversified credit portfolio, backed by strong collaterals, provides comfort on book quality. We recommend Buy on the stock with a price target (PT) of Rs. 180.

Key positives

- CASA at 25.70% improved from 24.61 % in Q1FY2021; CASA growth remained strong y-o-y to touch Rs. 10,644.6 crore, an upside of 7%.
- NNPA improved by 90bps to reach 1.81% (from 2.1% in Q1FY2021); PCR ratio improved by 200bps q-o-q to 70%.
- Cost to Income (C/I) declined to 40.31% in in Q2FY2021 (from 42.87% in Q1FY2021)

Key negatives

- Deposit growth remained flat (up 2.4% y-o-y; up 1% q-o-q) at Rs. 41,420 crore.
- Return on Equity (ROE) for the quarter came at 11.50%, down from 15.18% in Q2FY2020.

Our Call

Valuation: CUBK currently trades at 1.8x/1.5x its FY2022E/FY2023E book value, which we believe is reasonable. Notwithstanding the pandemic impact, CUBK's management commentary was encouraging with management indicating better pickup in business and asset-quality stress easing out. We have fine-tuned our FY2021E/FY2022E estimates and have introduced FY2023E estimates. We believe CUBK's ability to maintain a relatively decent core operating/return ratios in the long term and is supported by strong execution of a focused management. We recommend Buy on the stock with a PT of Rs. 180.

Key Risks

Extension of lockdown and delay in economic revival will cause further risk of slippages, especially in the business banking and corporate segment.

Valuation — Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Interest Income	1,611	1,675	1,802	1,907	2,241
PAT	683	476	487	708	960
EPS (Rs.)	9.30	6.46	6.61	9.61	13.03
Book Value per Share (Rs)	65.91	71.83	77.78	86.42	98.15
PE (x)	16.3	23.5	23.0	15.8	11.7
P / BVPS (x)	2.3	2.1	2.0	1.8	1.5
RoE (%)	15.2%	9.4%	8.8%	11.7%	14.1%
RoA (%)	1.5%	1.0%	0.9%	1.2%	1.4%

Source: Company; Sharekhan estimates

Note: We now convert City Union Bank into a Stock Update; it was earlier a Viewpoint under our coverage

Operating performance was mixed

The bank earned net interest income of Rs. 475 crore as against Rs. 412 crore for the same period as compared to last year. Non-interest income of the bank was at Rs.169 crore in Q2FY2021 as against Rs. 195 crore for Q2FY2020. Income earned on CEB and charges decreased by Rs. 11 crore from Rs. 76 crore in Q2FY2020 to Rs. 65 crore in Q2FY2021 based on the instructions from Finance Ministry w.r.t. waiver of charges due to COVID-19 impact in Q1FY2021. Treasury income reduced to Rs. 69 crore in Q2FY2021 versus Rs. 79 crore in Q2FY2020.

Operating expense for Q2FY2021 was at Rs. 260 crore, stable during the previous year. Operating profit for Q2FY2021 was Rs. 385 crore as against Rs. 347 crore for the same period as compared to last year. The bank already holds a provision of Rs. 225 crore for COVID-19 as on June 30, 2020; and during the current quarter, the bank has made an additional provision of Rs. 115 crore to meet any future contingency arising out of COVID-19 pandemic. Thus, the total provision in this regard held by the bank as on September 30, 2020, is Rs. 340 crore.

The bank has restructured 11 standard accounts worth Rs. 79.4 crore in Q2FY2021 and total outstanding restructured standard accounts stood at Rs. 477.9 crore. The bank held an amount of Rs 14.1 crore for the said loans (against requirement of Rs. 13.1 crore).

No fresh sale to ARC on SR basis has been done since FY2018 and total SRs amounted to Rs. 242.7 crore, and payments in 90% of total SRs have started. Total loans under default as on October end stood at Rs. 397 crore categorised under SMA accounts, and total SMA accounts constitute ~1.1% of total advances, which we believe is manageable.

CUBK's PAT was at Rs. 158 crore in Q2FY2021 as against Rs. 194 crore in Q2FY2020. Profit before tax for the quarter was impacted on account of additional provision made worth Rs. 115 crore towards COVID-19 to meet any future contingency.

Key Concall Highlights

Moratorium: During June quarter, accounts covering an exposure of 1.76% of CC and 26.54% of term loan on total 12.45% of exposure did not received even a single payment utilising moratorium fully, which has been reduced to 0.65% of CC exposure, 19.12% of term loan exposure, and 9.03% of total exposure, where not even a single payment was received during the moratorium period. Out of them, 0.10% of CC exposure, 10.76% term loan exposure, and 4.94% of total exposure have paid demand portion of one monthly instalment in September 2020. Of the balance, 4.09% of exposure has not paid anything till now. CUBK expects many of them to opt for restructuring since the time is available up to December 31, 2020, for non-MSME and March 31, 2021, for MSME.

Restructuring: As of H1FY2021, the total outstanding restructured standard accounts was 175 in numbers amounting to Rs. 478 crore. The bank holds a provision of Rs. 14 crore against the requirement of Rs. 13 crore towards restructured standard accounts.

Growth: Current growth is derived from ECLGS accounts and gold loan disbursement. Bank is not pushing at the moment for growth due to COVID.

ECLGS: Across business lines, up to October 2020, the bank has sanctioned Rs. 1967 crore and disbursed Rs. 1,691 crore under ECLGS.

Guidance: Growth would be in higher single digits for FY2021. However, the bank indicated that growth is likely to prepone to Q4FY2021 from earlier guided Q1FY2022.

Deposit: Total deposits of the bank marginally increased by 2% for Q2FY2021 to Rs. 41,421 crore from Rs. 40,451 crore for the same period as compared to last year. We have not pushed for growth because of COVID-19 and to protect the margins along with optimum level of credit deposit ratio; the deposit position was kept muted in H1FY2021. However, it will push for growth if situation warrants by way of any surge in advances in the second half of FY2021. CASA increased by 7% from Rs. 9,988 crore to Rs. 10,645 crore (y-o-y). CASA portion stood at 25.70% to total deposits. Cost of deposits decreased to 5.54% from 6.25% in Q2FY2020.

Net Interest Margin: Net interest margin stood at 4.12% in Q2FY2021 after reversal of Rs. 25 crore during the quarter. If the reversal was not done, NIM would have been at 4.33%. There was pressure on yields for the bank.

Provision: Total SMA accounts constitute 1.11% of total advances. During H1FY2021, the bank has made an additional adhoc provision of Rs. 215 crore to meet any future contingency arising out of COVID-19 pandemic. The total provision in this regard held by the bank as on September 30, 2020, is Rs. 317 crore. Total COVID-19 provision held as on September 30, 2020, stood at 0.89% of total advances.

Results Rs cr

Particulars	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %
Interest income	1061.0	1036.8	2.3	1049.4	1.1
Interest expense	585.8	625.3	-6.3	612.4	-4.3
Net interest income	**475.1**	**411.5**	**15.5**	**437.0**	**8.7**
Non-interest income	169.3	195.0	-13.2	160.6	5.4
Net total income	644.5	606.5	6.3	597.6	7.8
Operating expenses	259.8	260.0	-0.1	241.5	7.6
Pre-provisioning profit	**384.7**	**346.5**	**11.0**	**356.1**	**8.0**
Provisions	177.0	108.0	64.0	157.0	12.7
Profit before tax	207.7	238.5	-12.9	199.1	4.3
Tax	50.0	45.0	11.1	45.0	11.1
Profit after tax	**157.7**	**193.5**	**-18.5**	**154.1**	**2.3**

Source: Company; Sharekhan Research

Outlook and Valuation

Sector view - Credit growth yet to pick up, private banks placed better

At the system level, the bank's credit offtake is still tepid, with credit growth of 5.26% in the fortnight ended September 11, indicating a continued scenario of weak credit offtake. However, deposits rose by 11.98 % (best since March 31, 2017) to Rs. 142.48 trillion, which indicates healthy deposit growth traction, helped by the accommodative stance of the RBI resulting in surplus liquidity, which provides succour in terms of lower cost of funds for banks and financials. The loan moratorium has duly ended, which is a relief. Going forward, the collection efficiency is likely to be a function of book quality, client profile as well as economic pickup. At present, we believe the banking sector is likely to see increased risk-off behaviour, with tactical market share gains for well-placed players. We believe private banks, with improved capitalisation and strong asset quality (with high coverage and provisions buffers) are structurally better placed to take-off once the situation normalises.

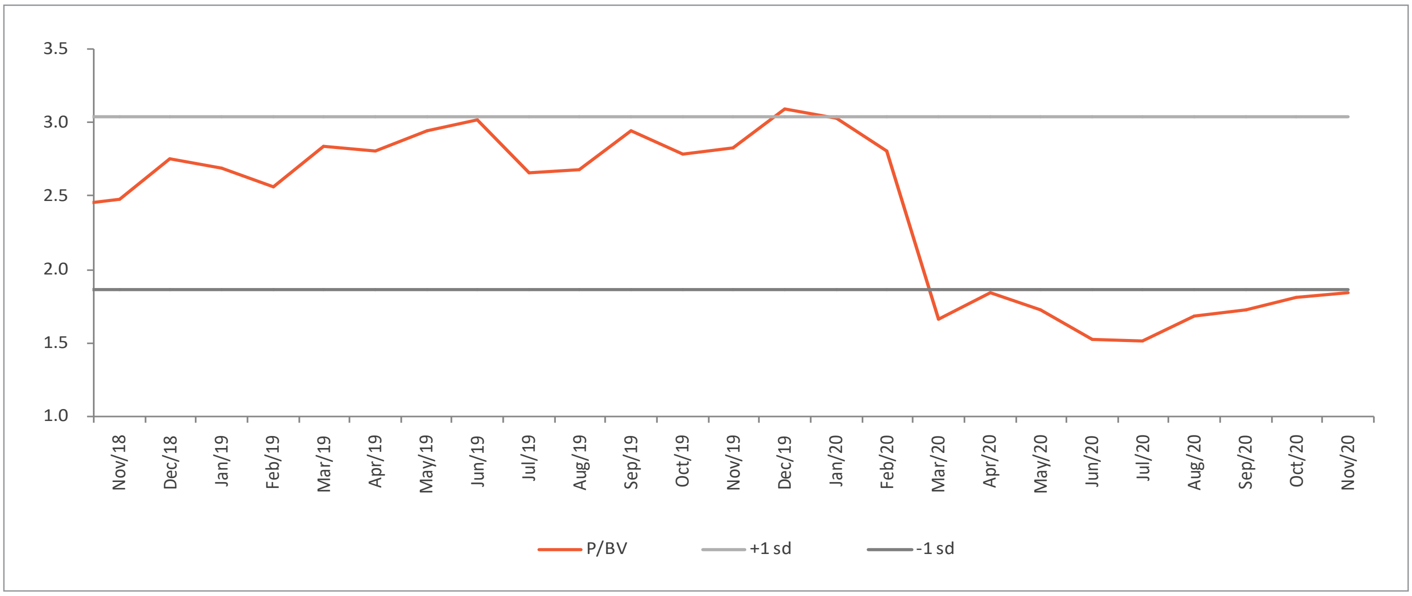
Company outlook - Promising outlook

We believe accompanying vectors around growth indicate the lender's sustainability and quality and CUBK differentiates itself with strong business and sustainability. Over the years, it has delivered a healthy and consistent core operating performance, staying away from risky areas and sticking to its strengths of a known clientele and geography. However, we believe core business principles (comfortable capitalisation, healthy margins, and stable asset quality) still hold for the long term. A granular asset profile with advances to top 20 borrowers, contributing around 8.5% of the book and 99% of loans being secured lending, backed by adequate collaterals, are comfort factors for investors.

Valuation - Maintain Buy, with a PT of Rs 180

CUBK currently trades at 1.8x/1.5x its FY2022E/FY2023E book value, which we believe is reasonable. Notwithstanding the pandemic impact, CUBK's management commentary was encouraging with the management indicating better pickup in business and asset-quality stress easing out. We have fine-tuned our FY2021E/FY2022E estimates and have introduced FY2023E estimates. We believe CUBK's ability to maintain a relatively decent core operating/return ratios in the long term is supported by strong execution of a focused management. We recommend Buy on the stock with a PT of Rs. 180.

One-year forward P/B (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
City Union Bank	151	2.0	1.8	23.0	15.8	0.9	1.4	8.8	13.5
RBL Bank	180	0.9	0.8	18.2	9.1	0.6	1.1	4.8	8.6
Federal Bank	52	0.7	0.6	9.1	6.2	0.6	0.8	7.9	10.0
IndusInd Bank	631	1.2	1.0	12.7	8.7	1.1	1.4	9.3	12.3

Source: Company, Sharekhan Research

About company

CUBK is an old private sector bank in India. The main focus of the bank has been on lending to MSME, retail/wholesale trade with granular asset profile including providing short-term and long-term loans to the agricultural sector. The bank had 700 branches, of which ~90% are in South India with ~70% in Tamil Nadu. The bank's gross loan book was at Rs. 34,500+ crore, wherein working capital loans constitutes ~63% of the total book. It is concentrated in Southern India, with nearly 71% of business coming from Tamil Nadu. CUBK has a comfortable capital position with CRAR of 17.36%, of which Tier-1 constitutes 16.29%.

Investment theme

CUBK is a private bank operating in the Southern Indian region, focused on the niche segment of working capital financing to MSMEs and traders, which forms ~50% of its total loan book. A granular business focus segment of SME borrowers and flexible working capital loans have allowed CUBK to sustain healthy margins over the years despite several intermittent turbulent times. Its conservatism in lending has resulted in healthy and well under-control NPAs levels. Moreover, several smart business decisions of the management such as staying away from consortium-based lending and scaling back segments where initial stress is seen have served it well. The impact of COVID-19 and the resultant lockdown impact poses risks to borrowers' cash flows and, therefore, may result in higher credit cost in the near to medium term and slower growth. However, factors such as strong capitalisation levels and a dependable liability franchise are positive factors for long-term investors.

Key Risks

Extension of lockdown and delay in economic revival will cause further risk of slippages, especially in the business banking and corporate segment.

Additional Data

Key management personnel

Dr N. Kamakodi	M.D & C.E.O.
Shri. R. Mohan	Non-Executive Chairman
R.Venkatasubramanian	Chief General Manager& COO
K. P. Sridhar	Senior General Manager

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	4.72
2	HDFC Asset Management Co Ltd	4.5
3	HDFC Trustee Co Ltd/India	4.5
4	Life Insurance Corp of India	4.1
5	Axis Asset Management Co Ltd/India	4.1
6	AXIS MUTUAL FUND MIDCAP	3.9
7	Capital Group Cos Inc/The	3.8
8	Wasatch Advisors Inc	3.1
9	PRIVATE EQUITY FUND	2.9
10	HDFC Life Insurance Co Ltd	2.5

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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