Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

City Union Bank

On road to business normalisation

Banks & Finance	Sharekhan code: CUB	Company Update

Stock Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 186**	
Price Target: **Rs. 225**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

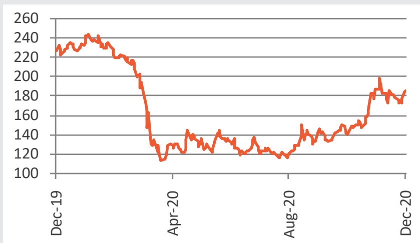
Company details

Market cap:	Rs. 13,745 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	-0.5	29.9	41.4	-18.0
Relative to Sensex	-6.5	10.5	2.1	-31.0

Sharekhan Research, Bloomberg

Summary

- We interacted with City Union Bank's management to understand the present business scenario, asset quality, and growth outlook. Management indicated that collection efficiency has been improving on m-o-m basis and is near-normal levels now.
- The bank is well placed on the asset-quality front, with a manageable level of restructuring and adequate provision cover.
- City Union Bank trades at 2.1x/1.9x its FY2022E/FY2023E BVPS. Factors such as increasing retail focus, being adequately capitalised (Tier-1 at ~16.3%), and incremental lending to better-rated borrower(s) are positives.
- We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 225.

We interacted with the management of City Union Bank to understand the present business scenario, asset quality, and growth outlook. Management indicated that collection efficiency has been improving on m-o-m basis, which is encouraging and is at near-normal levels now. The bank is well placed on the asset-quality front, with a manageable level of restructuring and adequate provision cover. Growth outlook is also stable. Management has accepted restructuring requests of Rs. 1,500 crore so far (mostly from hotels and marriage halls) and has already done Rs. 380 crore by Q2FY2021 and the appetite for restructuring has been manageably low. The bank expects low slippages in Q3 due to the continuation of court's orders on NPA recognition, but expects SMA category loans (Rs. 385 crore) to be the main pipeline for NPAs in Q4. Management indicated that it expects credit growth of ~8% for FY2021E and expects margins to be maintained at around 4% levels, supported by falling cost of funds. Going forward, the bank expects cost/income (C/I) to be at 42%-44% on normalised basis. The bank has healthy capitalisation levels, at 16.3% (18% if H1 PAT is ploughed back), which is adequate for the medium term. We prefer a constructive medium to long-term view on the bank, as we build upon our expectation that credit quality cycle will normalise in the next few years and City Union Bank would likely be a key beneficiary of this reversal. However, the bank has a niche franchise with a proven history of conservative lending, which supports our positive outlook. The bank is comfortably placed on the liabilities side, with minimal reliance on corporate bulk deposits (only 11% of total deposits are above Rs. 2 crore). The bank 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 and 95% secured book etc., provides comfort on book quality. We have fine-tuned our estimates and the target multiple in light of the improved outlook. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 225.

Our Call

Valuation: City Union Bank trades at 2.1x/1.9x its FY2022E/FY2023E BVPS. Factors such as increasing retail focus, being adequately capitalised (Tier-1 at ~16.3%), and incremental lending to better-rated borrower(s) are positives. The bank's management commentary is encouraging, indicating better pickup in business by the end FY2021 and asset-quality stress easing out. We have fine-tuned our estimates and the target multiple in light of the improved outlook. We believe the bank'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 revised PT of Rs. 225.

Key Risks

Uncertainty over loan restructuring and delay in economic recovery pose risks to the bank's profitability in the near to medium term.

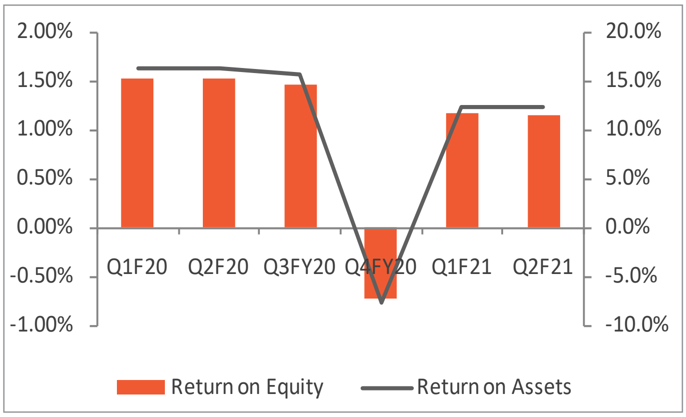
Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Interest Income	1,611	1,675	1,802	1,907	2,295
PAT	683	476	487	725	1,048
EPS (Rs.)	9.30	6.46	6.61	9.83	14.21
Book Value per Share (Rs.)	65.91	71.83	77.78	86.63	99.42
PE (x)	20.0	28.8	28.1	18.9	13.1
P / BVPS (x)	2.8	2.6	2.4	2.1	1.9
RoE (%)	15.2%	9.4%	8.8%	12.0%	15.3%
RoA (%)	1.5%	1.0%	0.9%	1.2%	1.6%

Source: Company; Sharekhan estimates

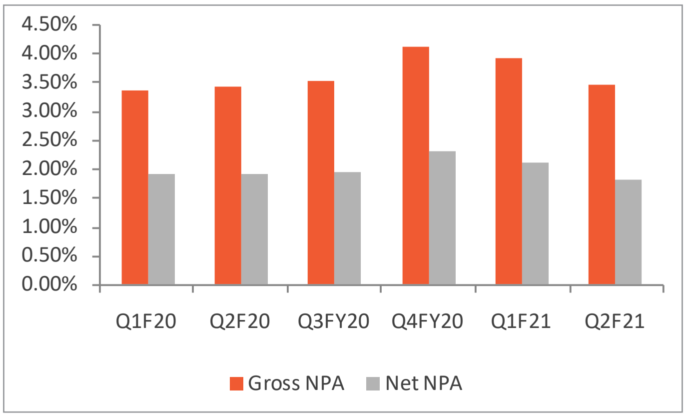
Financials in charts

Return Ratios



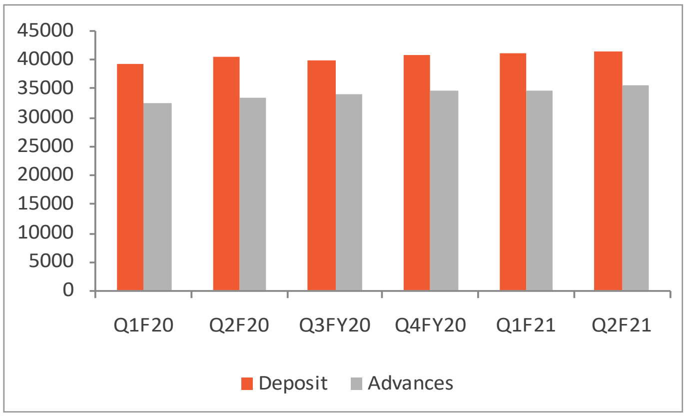
Source: Company, Sharekhan Research

Asset Quality



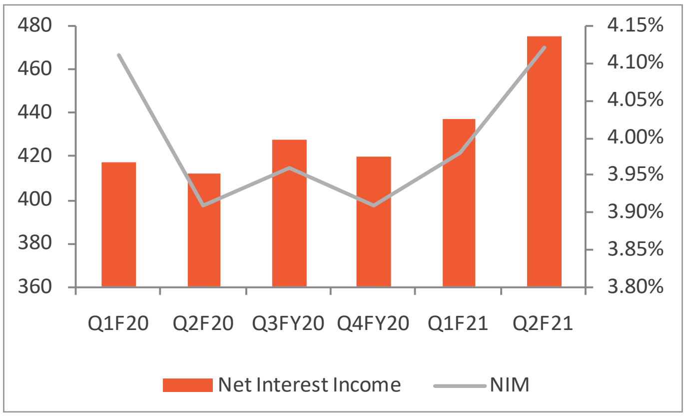
Source: Company, Sharekhan Research

Business Growth



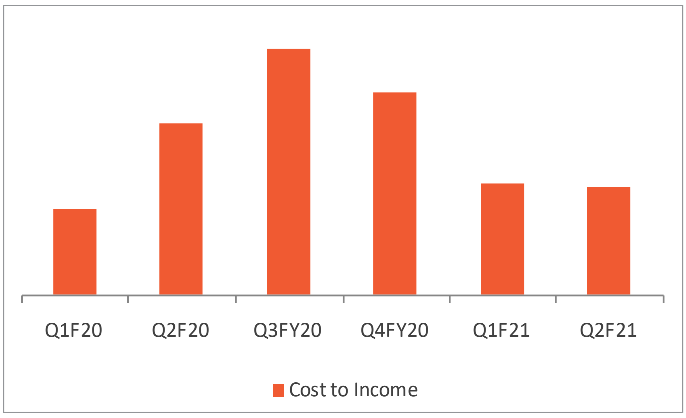
Source: Company, Sharekhan Research

NII, NIMs



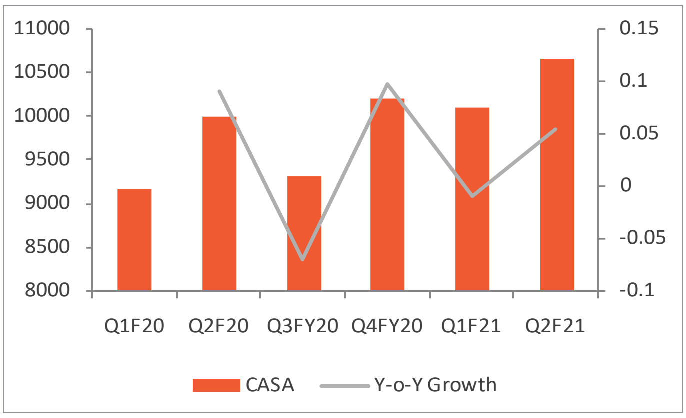
Source: Company, Sharekhan Research

Cost efficiencies



Source: Company, Sharekhan Research

CASA



Source: Company, Sharekhan Research

Outlook and Valuation

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

Even though at the system level the bank's credit offtake is still tepid, with credit growth of sub 6%, we believe private banks (PBs) with their better capital position, strong business case, and lower competition in most segments for PSU banks are well placed to grow and gain market share. The accommodative stance of the Reserve Bank of India (RBI) resulting in surplus liquidity 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, 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 gradual return to normalcy in business, led by PBs with tactical market share gains for well-placed players. We believe PBs with improved capitalisation and strong asset quality (with high coverage and provisions buffers) are structurally better placed to take-off once the situation normalises.

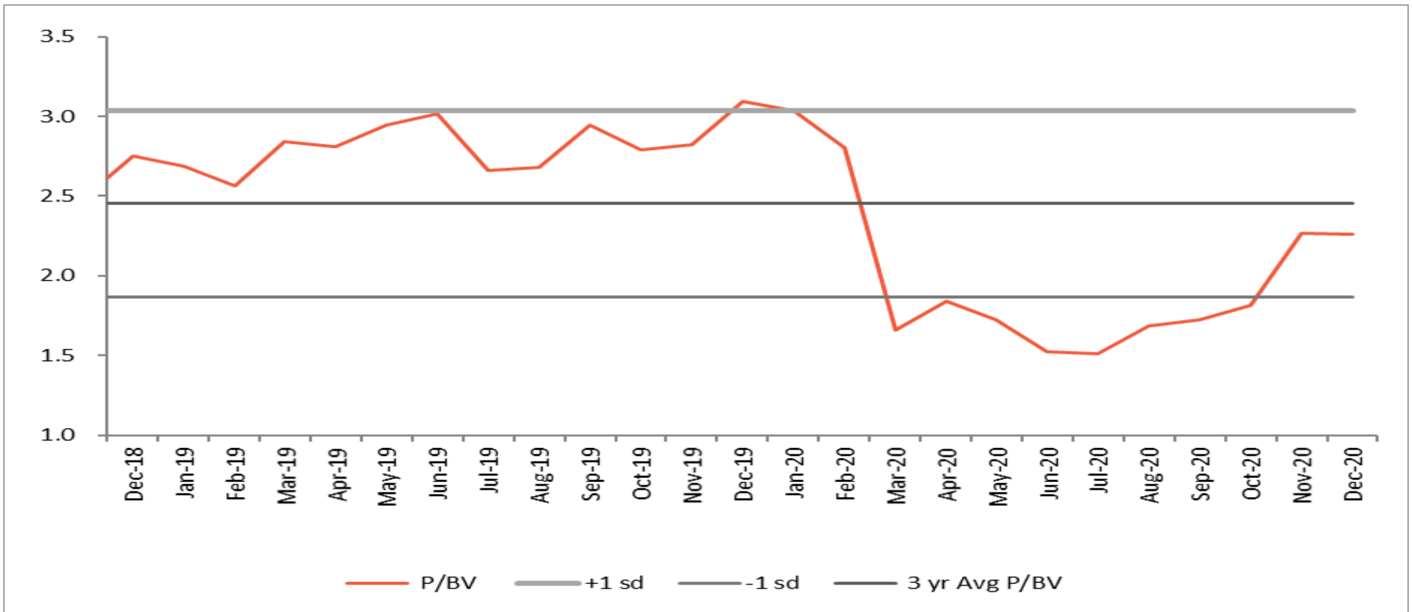
■ Company outlook - Promising outlook

We believe accompanying vectors around growth indicate the lender's sustainability and quality and City Union Bank differentiates itself with strong business and sustainability. Over the years, the bank 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% to the book and 99% of loans being secured lending, backed by adequate collaterals, are comfort factors for investors.

■ Valuation - Maintain Buy, with a revised PT of Rs. 225

City Union Bank trades at 2.1x/1.9x its FY2022E/FY2023E BVPS. Factors such as increasing retail focus, being adequately capitalised (Tier-1 at ~16.3%), and incremental lending to better-rated borrower(s) are positives. The bank's management commentary is encouraging, indicating better pickup in the business by the end FY2021 and asset-quality stress easing out. We have fine-tuned our estimates and target multiple in light of improved outlook. We believe the bank'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 revised PT of Rs. 225.

One-year forward P/BV (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
City Union Bank	186	2.4	2.1	28.1	19.3	0.9	1.4	8.8	13.5
Federal Bank	67	0.9	0.8	11.7	8.0	0.6	0.8	7.9	10.0
IndusInd Bank	927	1.7	1.5	18.6	12.7	1.1	1.4	9.3	12.3

Source: Bloomberg, Sharekhan Research

About company

City Union Bank is an old private sector bank in India. The bank mainly focuses on lending to MSME and 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 constitute ~63% of the total book. The bank is concentrated in Southern India, with nearly 71% of business coming from Tamil Nadu. The bank has a comfortable capital position with CRAR of 17.36%, of which Tier-1 constitutes 16.29%.

Investment theme

City Union Bank is a private bank operating in 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 the bank to sustain healthy margins over the years despite several intermittent turbulent times. The bank's conservatism in lending has resulted in healthy and well under-control NPA 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 pose risks to borrowers' cashflows 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 for long-term investors

Key Risks

Any significant increase in prices of key inputs or heightened competition in core product categories would act as a key risk to our earnings estimates.

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	HDFC Asset Management Co Ltd	4.5
2	HDFC Trustee Co Ltd/India	4.5
3	Axis Asset Management Co Ltd/India	4.4
4	Life Insurance Corp of India	4.1
5	Capital Group Cos Inc/The	3.1
6	Wasatch Advisors Inc	3.0
7	HDFC Life Insurance Co Ltd	2.8
8	Franklin Resources Inc	2.7
9	SBI Funds Management Pvt Ltd	2.7
10	DSP Investment Managers Pvt Ltd	2.3

Source: Bloomberg

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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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