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Stock Update

City Union Bank

Soft quarter, reasonable valuation

Banks & Finance	Sharekhan code: CUB	Result 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. 174**	
Price Target: **Rs. 225**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

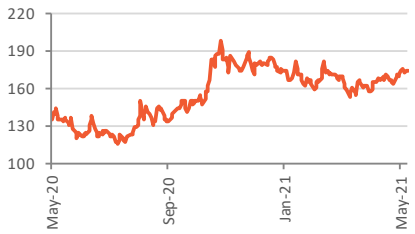
Company details

Market cap:	Rs. 1,2848 cr
52-week high/low:	Rs. 200 / 116
NSE volume: (No of shares)	23.5 lakh
BSE code:	532210
NSE code:	CUB
Free float: (No of shares)	73.8 cr

Shareholding (%)

Promoters	-
FII	19.9
DII	41.2
Others	38.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	7.9	-9.2	28.5
Relative to Sensex	-0.3	4.6	-27.2	-30.1

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on the stock of City Union Bank with an unchanged price target (PT) of Rs. 225.
- The bank reported sub-par numbers for Q4 FY2021, where asset quality deteriorated sequentially; and elevated provisions and interest reversal caused PAT to marginally miss estimates.
- The quarter saw asset quality headwinds, which resulted in Net interest margins (NIMs) declined q-o-q to 3.72% (down 44BPS) due to higher interest reversals, restructured standard advances to gross advances ratio stood at 4.99%.
- The stock trades at 1.9x/1.6x its FY2022E/FY2023E BVPS. Factors such as increasing retail focus, being adequately capitalised (Tier-1 at ~18.5%), and incremental lending to better-rated borrower(s) are positives; high secured loans proportion are comfort factors.

City Union Bank (CUBK) posted sub-par results; with operating results coming lower then estimates and Reported asset quality declined sequentially. Net Interest Income (NII) stood at Rs 428 crores, down 12.4% q-o-q and up 2.2% on a y-o-y basis, coming below estimates. The provisions were elevated, at Rs 284.7 crores, up 9.2% q-o-q but down 47% y-o-y due to which, the PAT came at Rs 111 crores, down 34.6% q-o-q . During FY2021, CUB made an adhoc COVID provision of Rs.340 Crore up to 9M FY 21 and Rs 125 crores made in Q4 FY20. During Q4 FY2021, the bank had written back Rs.309 crores utilizing it for NPA provision. The quarter saw asset quality headwinds, while Net interest margins (NIMs) declined q-o-q to 3.72% from 4.16% in Q3FY2021 due to higher interest reversals impact due to the spill over effect of the prior quarters as well. However, for FY2021, the NIMs stood at 4%, steady compared to 3.98% in FY2020. Reported GNPA / NNPA deteriorated, and climbed to 5.11% / 2.97% from reported figures of 4.09% / 2.29% for FY2020. CUB has restructured Standard borrower accounts of Rs.521 crores (MSME) and Rs.595 crores under Covid-19 Resolution Framework (Non MSME) in Q4 FY 2021. As of FY2021, the total outstanding restructured standard borrower accounts was Rs.1849.3 crores (4.99% of advances). The Bank held standard accounts provision for restructured accounts of Rs.122 crores. The management commentary was cautiously optimistic, with the management indicating an improved pickup in business volumes and guided for a return to growth by H2FY2022 and asset quality stress also 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, while near-term slippages or earnings visibility is likely to be murky, due to its customer profile the fact that it has a diversified and granular credit portfolio backed by adequate collaterals (99% are secured loans) we believe eventual loss-given defaults (LGD) to be manageable. CUBK has a niche franchise with a proven history of conservative lending, which supports our positive outlook. We expect NIM to be stable for FY2022E, with a positive bias due to the effect of deposit re-pricing and lower credit costs. CUBK has a quality franchise and a conservative lending approach, which differentiates it from several similar-sized peers. We believe these attributes still hold strong. We maintain a Buy rating on the stock with an unchanged price target (PT) of Rs. 225.

Key positives

- Strong business traction, especially in deposits side, with Deposits growing by 9% y-o-y and CASA ratio Improving to 29% from 25% in FY2020.
- Return ratios ROA & ROE for FY2021 improved to 1.15% & 10.73%, respectively from 1% and 9.47% in FY2020.

Key negatives

- Net Interest Margin for Q4 FY2021 stands reduced to 3.72% because of reversal of interest on NPA accounts to the tune of Rs.125 crores (Rs 55 cr for Q2 & Q3 FY2021 and Rs 70 crores for Q4). If this impact is nullified the NIM for Q4 FY 2021 would have been at normal level of 4% plus.

Our Call

Valuation: City Union Bank trades at 1.9x/1.6x its FY2022E/FY2023E BVPS which are reasonable. Factors such as an increasing retail mix, adequately capital (Tier-1 ratio of ~18.5%), and incremental lending to better-rated borrower(s) are positives. The bank's management commentary indicating better pickup in business by FY2022E and asset-quality stress easing out in the medium term. 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 maintain a Buy on the stock with an unchanged PT of Rs. 225.

Key Risks

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

Valuation Rs cr

Particulars	FY19	FY20	FY21	FY22E	FY23E
Net Interest Income	1,611	1,675	1,830	2,203	2,645
PAT	683	476	593	976	1,344
EPS (Rs)	9.30	6.46	8.04	13.24	18.23
Book Value per Share (Rs)	65.9	71.8	79.1	91.0	107.4
PE (x)	18.7	26.9	21.6	13.1	9.5
P / BVPS (x)	2.6	2.4	2.2	1.9	1.6
RoE (%)	15.2	9.4	10.7	15.6	18.4
RoA (%)	1.5	1.0	1.2	1.6	2.0

Source: Company; Sharekhan estimates

Key Concall Highlights

- **Guidance:** Slippages will be frontloaded for FY2022E. Overall, GNPA and NNPA to be lower than FY2021 ending, even though there may be quarterly spikes. Hope that FY2022 will not be as bad as FY2021.
- **SMA2** are around 4.99%, much lower than earlier years band. Because of standstill clause removed, the NPA addition have become current and been recognised.
- **Slippage:** Proforma Slipppage of Rs 1134 crores were for 9M FY2021, but actual slippage for FY2021 was Rs 1110 crores. Repayments and collections helped keep in check.
- **Collections:** Collections improved in Q4, that is why the slippages were contained.
- **Covid Impact accounts:** First category of customers impacted which had problems before the advent (before 29th Feb). The second category was to those whose net worth has been wiped out due to expenses. Going forward, a lot of viable business of hotels etc which had a genuine business but saw cashflow dry up due to the first wave of COVID, would be the ones that will be vulnerable in the second wave .
- **Credit Growth:** Expect credit growth of mid to higher single digits for FY2022, in line with growth seen in FY2021.
- **Recovery Rate:** Recovery rate is usually 65-70% of slippages. That is why don't focus too much on PCR as most exposures are collateralised. Assuming by September things to normalize, post which bank would be requiring around 4 quarters of time for recovery of NPLs.
- **Other Opex:** The bank indicated that around 8% growth in opex is normal. Other Operating Expenses last year had grown lower by ~8% so it was on lower base. There was no one-offs in Q4.
- **Gold Loan** strong growth seen due higher demand and propensity of bank to grow it due to the lack of other avenues.
- **Credit cost normalization:** It is function of slippage, NPA recovery and provision target. In FY2022E expect slippage level to be better than FY2021, but could be front loaded due to lockdown etc.
- **ECLGS scheme** was not available to SMEs already under stress before. Hence they were automatically eliminated from this scheme.
- **New fraud account** of Govt Telecom Deptt cooperative account, where bank had relation sine 2010. They borrowed Rs 25 crores, in 2018, (now Rs 11 crores outstanding) CUBK had no problems, but since other lenders had problem with the account, CUBK also had to recognise it as fraud.
- **Collections Outlook:** However, due to the second wave, there has been an impact on collections etc. Impact on growth will not be as bad as in FY2021 beginning as per bank's assessment.
- **Restructured Assets:** During Q4 FY2021 the bank restructured Rs 1849 crores.
- **C/I:** for the Q4 was 51% due to interest reversals of Rs 14.4 crores and slippages.
- **SME Outlook:** Not as bad as FY2021. Currently, the cash flow for SME are not zero unlike the Lockdown earlier. Also, many borrowers had existing problems even before COVID. Majority of business the activity in last 2-3 months, have seen strong turnover, and people have also learnt to manage businesses better.
- **NPL recognition:** Has taken a bulk of hit in FY2020 and FY2021, hence FY2022 will be slightly better than earlier years.
- **Effective Tax Rate:** Have moved to the new tax regime and taken the Defferred tax impact and other impact. For FY2022E the effective tax rate would be ~26% but final number will be dependent on mix of income etc.

Results **Rs cr**

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Interest income	976.3	1,041.7	-6.3	1,048.0	-6.8
Interest expense	547.8	622.2	-12.0	559.0	-2.0
Net interest income	**428.5**	**419.5**	**2.2**	**489.0**	**-12.4**
Non-interest income	145.1	179.3	-19.1	229.8	-36.9
Operating expenses	288.9	263.7	9.6	260.4	11.0
- Employee cost	107.2	93.8	14.3	120.2	-10.8
- Other Costs	181.7	169.9	6.9	140.2	29.6
Pre-provisioning profit	**284.7**	**335.1**	**-15.0**	**458.4**	**-37.9**
Provisions	238.5	450.4	-47.0	218.5	9.2
Profit before tax	46.2	-115.3	NA	239.9	-80.7
Tax	-65.0	-20.0	NA	70.0	-192.9
Profit after tax	**111.2**	**-95.3**	**NA**	**169.9**	**-34.6**

Source: Company; Sharekhan Research

Outlook and Valuation

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

System-level credit offtake, which is still subdued, is now improving, albeit still sluggish, and is with credit growth of ~6% in the recent few prints. On the other hand, deposits have been growing by ~12%, which indicate a reasonably healthier economic scenario. Moreover, the accommodative stance of the RBI, resulting in surplus liquidity, provides succour in terms of easy availability of funds and lower cost of funds for banks and financials. Going forward, collection efficiency is likely to be a function of book quality, client profile, as well as economic pickup along with the likely pace of pandemic-induced lockdowns and the severity of the same. 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.

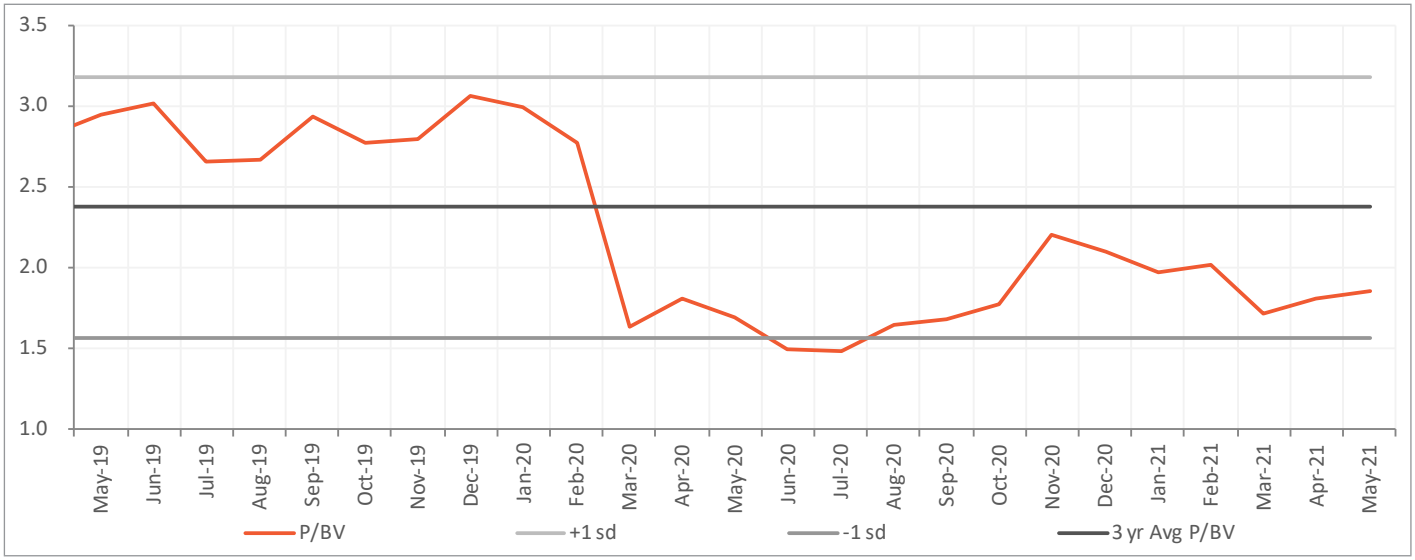
■ Company outlook - Promising outlook

We believe accompanying vectors around growth indicate CUBK'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 good for the long term. A granular asset profile with advances to top 20 borrowers, contributing ~8.5% to the book and 99% of loans being secured lending, backed by adequate collaterals, are comfort factors for investors.

■ Valuation - Maintain a Buy on the stock with unchanged PT of Rs. 225

City Union Bank trades at 1.9x/1.6x its FY2022E/FY2023E BVPS. Factors such as an increasing retail mix, adequately capital (Tier-1 ratio of ~18.5%), and incremental lending to better-rated borrower(s) are positives. The bank's management commentary indicating better pickup in business by FY2022E and asset-quality stress easing out in the medium term. 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 maintain a Buy on the stock with an unchanged PT of Rs. 225.

One-year forward P/BV chart



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
City Union Bank	174	2.2	2.0	26.3	18.0	0.9	1.4	8.8	13.5
Federal Bank	89	1.0	0.9	8.4	6.8	0.9	0.9	12.4	13.8
IndusInd Bank	1019	1.7	1.5	14.1	12.1	1.1	1.1	12.3	12.7

Source: Company, 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. 37,000+ 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 19.52 %, of which Tier-1 constitutes 18.45%.

Investment theme

City Union Bank is a private bank operating in Southern Indian, 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

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

Additional Data

Key management personnel

Dr N. Kamakodi	M.D & C.E.O
Shri. V Ramesh	CFO/Gen Mgr/Secretary
R.Venkatasubramanian	Chief General Manager & COO
K. P. Sridhar	Senior General Manager

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co Ltd/India	4.9
2	HDFC Asset Management Co Ltd	4.5
3	Life Insurance Corp of India	4.1
4	Franklin Resources Inc	3.9
5	DSP Investment Managers Pvt Ltd	3.5
6	ICICI Prudential AMC	3.0
7	HDFC Life Insurance Co Ltd	2.9
8	SBI Funds Management Pvt Ltd	2.8
9	Capital Group Cos Inc	2.3
10	L&T Mutual Fund Trustee	1.6

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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