Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

City Union Bank

Healthy recovery from w/o accounts aided strong performance

Bank	Sharekhan code: CUB

Reco/View: Buy	↔	CMP: **Rs. 163**	Price Target: **Rs. 196**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 35.21

Updated July 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

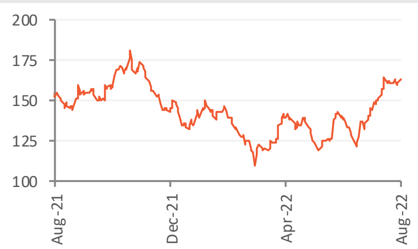
Company details

Market cap:	Rs. 12,041 cr
52-week high/low:	Rs. 184/ 109
NSE volume: (No of shares)	23.8 lakh
BSE code:	532210
NSE code:	CUB
Free float: (No of shares)	71.7 cr

Shareholding (%)

Promoters	-
FII	18.2
DII	41.7
Others	40.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.4	29.4	17.3	5.2
Relative to Sensex	2.9	22.0	16.9	-3.3

Sharekhan Research, Bloomberg

Summary

- City Union Bank (CUB) reported PAT at Rs. 225 crore (up 30% yoy/8% qoq), led by strong operational performance and contained credit cost. Higher NII growth and healthy recoveries from written-off accounts aided to strong operational performance despite higher opex.
- NII grew by 17% y-o-y/5% q-o-q; however, NIM declined by 6 bps qoq to 3.95%. Operating profit grew by 17% y-o-y/2% q-o-q, led by healthy NII growth and higher other income (due to higher recoveries), offsetting higher opex growth.
- Overall asset quality remained stable due to higher write-offs, with GNPA and NNPA ratios falling by 5bps/6bps q-o-q to 4.65%/2.89%. PCR improved to 39%. Gross slippages were higher by 22% qoq at Rs. 270 crore.
- At the CMP, CUB trades at 1.8x and 1.5x its FY2023E and FY2024 ABV, respectively. We maintain our Buy rating on the stock with a revised PT of Rs. 196. We believe there is some more headroom in valuations to catch up on improved growth outlook and better return ratio profile.

City Union Bank (CUB) reported overall strong performance in Q1FY2023. Net interest income (NII) grew by 17% y-o-y/5% q-o-q (in line with estimates), led by healthy loan growth. Net interest margin (NIM), however, declined by 6 bps on a q-o-q basis to 3.95%. Core fee income grew strongly by 25% y-o-y/8% q-o-q. Other income was higher by 4% y-o-y/7% q-o-q due to higher recoveries from written-off accounts (Rs. 112 crore vs. Rs. 74 crore qoq and Rs. 23 crore yoy). The bank reported treasury gains of Rs. 21 crore vs. Rs. 50 crore last quarter. Total operating expenses grew by 13% y-o-y/12% q-o-q. Operating profit reported was 21% above our estimates, growing by 17% y-o-y/2% q-o-q, mainly due to higher other income and increased NII despite higher opex growth. Provisions were down 11% y-o-y/11% q-o-q. Total credit cost stood at 1.5% of average advances during the quarter vs. 1.7% in the last quarter. PAT reported was 24% above estimates, growing by 30% y-o-y/8% q-o-q, led by higher operating profit and contained credit cost. Advances grew by 12% y-o-y/1% q-o-q. Deposits grew by 9% y-o-y, with CASA growing at 25% y-o-y. Overall asset quality remained stable with GNPA and NNPA declining by 5 bps/6 bps q-o-q to 4.65%/2.89%. Gross slippages were higher 22% qoq at Rs. 270 crore versus Rs. 221 crore q-o-q. Restructured book stood at Rs. 2,034 crore (~5.0% of advances) versus Rs. 2,184 crore (5.4% of advances) sequentially.

Key positives

- Stable asset quality
- Robust CASA growth
- Higher recovery seen from W/O account during the quarter

Key negatives

- Gross slippages were higher sequentially
- Higher opex growth

Management Commentary

- The bank expects 15%-18% loan growth in FY23E vs. earlier guided range of 12%-15% on account of improved demand and good visibility. NIM is likely to be at 3.90-4.0% for FY23E.
- Collections have been improving in the restructured book, which would result in lower slippages (2-2.5%) and contained credit cost going ahead.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 196: At the CMP, CUB trades at 1.8x and 1.5x its FY2023E and FY2024E ABV, respectively. We believe there is still some more headroom in valuations to catch up on improved growth outlook and better return ratio profile. As economic activity picks up, with improving asset quality, higher recoveries, reduction in slippages, lower credit cost, and higher capital levels, the bank is well positioned to gain market share on the business front. We believe the bank could deliver superior return ratios among small-mid cap private banks, has stable management team, strong underwriting ability, and healthy capital position, which would augur well for future. We maintain our Buy recommendation on the stock with a PT of Rs. 196.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost could affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
NII	1,830	1,916	2,399	2,839
PAT	593	760	901	1,227
EPS (Rs.)	8	10.3	12.2	16.6
P/E (x)	20.3	15.8	13.4	9.8
P/ABV (x)	2.4	2.1	1.8	1.5
RoE (%)	10.6	12.2	12.8	15.1
RoA (%)	1.2	1.3	1.4	1.8

Source: Company; Sharekhan estimates

Key Results Highlights

- **Strong NII growth and higher other income led by healthy recoveries boost operating performance:** NII grew by 17%y-o-y/5% q-o-q, led by healthy loan growth. However, NIM declined by 6 bps q-o-q to 3.95%. Core fee income grew strongly by 25% y-o-y/8% q-o-q. Other income was higher by 4% y-o-y/7% q-o-q due to higher recoveries from written-off accounts (Rs. 112 crore vs. Rs. 74 crore qoq and Rs. 23 crore y-o-y). The bank reported treasury gains of Rs. 21 crore vs. Rs. 50 crore last quarter. Going forward, the bank expects to sustain margin around ~4% with 10-20 bps in FY2023E.
- **Stable asset-quality trends:** Overall, asset quality remained stable with GNPA and NNPA ratios declining by 5 bps/6 bps q-o-q to 4.65%/2.89%. Restructured book stood at Rs. 2,034 crore (~5% of advances) versus Rs. 2,184 crore (5.4% of advances) sequentially. Gross slippages were at Rs. 270 crore versus Rs. 221 crore q-o-q, rising 22% q-o-q. Upgrades and recovery amounted to Rs. 160 crore versus Rs. 211 crore q-o-q. Write-offs were at Rs. 140 crore versus Rs. 76 crore in the past quarter. Management expects recoveries to improve further in FY2023E. Collections have been improving in the restructured book, which would result in lower slippages (2-2.5%) and contained credit cost going ahead.
- **Improved credit growth outlook:** Advances grew by 12% y-o-y/1% q-o-q. The bank expects 15%-18% loan growth in FY23E vs. earlier guided range of 12%-15% on account of improved demand and good visibility. The bank has also launched credit cards, targeting existing customers in a risk-calibrated manner with tie-ups with other players in the industry.

Results Rs cr

Particulars	Q1FY23	Q4FY22	Q1FY22	y-o-y	q-o-q
Interest Income	1,099	1,050	997	10%	5%
Interest Expenses	575	549	550	4%	5%
Net Interest Income	**525**	**501**	**448**	**17%**	**5%**
NIM (%)	3.95	4.01	3.86		
Core fee income	85	79	68	25%	8%
Other Income	133	124	128	4%	7%
Net Operating Revenue	**742**	**704**	**643**	**15%**	**6%**
Employee Expenses	133	114	129	3%	17%
Other Opex	163	150	131	24%	8%
Total Opex	**295**	**264**	**260**	**13%**	**12%**
Cost-to-Income Ratio (%)	**39.8%**	**37.5%**	**40.5%**		
Pre-Provision Profits	**447**	**440**	**383**	**17%**	**2%**
Provisions & Contingencies - Total	152	171	170	-11%	-11%
Profit Before Tax	**295**	**269**	**213**	**39%**	**10%**
Tax	70	60	40	75%	17%
Effective Tax Rate (%)	23.7	22.3	18.8		
Reported Profits	**225**	**209**	**173**	**30%**	**8%**
Basic EPS (Rs.)	3.0	2.8	2.3	30%	7%
Diluted EPS (Rs.)	3.0	2.8	2.3		
RoA (%)	1.5	1.4	1.3		
Advances	40,934	40,358	36,396	12%	1%
Deposits	48,772	47,690	44,606	9%	2%
Gross NPA	1,904	1,933	2,035	-6%	-2%
Gross NPA Ratio (%)	4.65	4.70	5.59		
PCR - (%)	39.0	38.4	39.0		
Net NPA	1,161	1,191	1,242	-7%	-3%
Net NPAs Ratio (%)	2.89	2.95	3.49		

Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Credit growth accelerating; Top private banks placed better

System-level credit offtake grew by ~13.3% y-o-y in the fortnight ending June 17, 2022, indicating loan growth has been sustaining, given distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.8%, which also reflects a healthier economic scenario but are trailing advanced growth. The bottom-up story is intact and we should see loan growth accelerate, while margins would continue to expand in a higher interest rate cycle. Asset quality is not a big issue from the end of the corporate loan, as only de-leveraging is being observed. From the retail side, there could be some pressure but nothing is significant. Asset quality is likely to remain stable except for the MFI segment. Banks are in a sweet spot in terms of fundamentals and reasonable valuations. In the past two years, banks have been cautious on lending to BB and below, thus general risk, that they are carrying on corporate portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit cost. In terms of MSMEs, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

Company Outlook – Attractive franchise over the long term

We believe accompanying vectors around growth indicate CUB's sustainability and quality. The 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 assets backed by adequate collaterals are comfort factors for investors.

Valuation – Maintain Buy with a revised PT of Rs. 196

At the CMP, CUB trades at 1.8x and 1.5x its FY2023E and FY2024E ABV, respectively. We believe there is still some more headroom in valuations to catch up on improved growth outlook and better return ratio profile. As economic activity picks up, with improving asset quality, higher recoveries, reduction in slippages, lower credit cost, and higher capital levels, the bank is well positioned to gain market share on the business front. We believe the bank could deliver superior return ratios among small-mid cap private banks, has stable management team, strong underwriting ability, and healthy capital position, which would augur well for future. We maintain our Buy recommendation on the stock with a PT of Rs. 196.

Peer valuation

Banks	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
City Union Bank	163	12,040	13.4	9.8	1.8	1.5	12.8	15.1	1.4	1.8
AU Small Finance Bank	650	40,972	30.3	25.2	4.7	4.0	16.5	16.8	1.7	1.7

Source: Company, Sharekhan Research

About company

CUB 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 has 727 branches, of which ~90% are in South India with ~73% business coming from Tamil Nadu. The bank's gross loan book is at Rs. 41,000+ crore, focused on the niche segment of working capital financing to MSMEs and traders. The bank has a comfortable capital position with CRAR of 20.48%, of which Tier-1 constitutes 19.42%.

Investment theme

CUB 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-focused 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. We believe pandemic-related stress is largely behind and the bank is poised well for future growth.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost could affect earnings.

Additional Data

Key management personnel

Mr. M. Narayanan	Chairman
Dr N. Kamakodi	MD and CEO
Mr. V Ramesh	CFO/Gen Mgr/Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co.	4.5
2	Axis Asset Management Co. Ltd.	4.1
3	Franklin Resources Inc.	3.9
4	Capital Group Co. Inc.	3.5
5	Life Insurance Corp of India	3.2
6	Smallcap World Fund	3.0
7	DSP Investment Managers Pvt. Ltd.	2.7
8	SBI Fund Management Ltd.	2.5
9	ICICI Prudential AMC	2.4
10	Canara Robeco AMC	2.2

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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