Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

City Union Bank

Weak Q4, muted outlook

Banks	Sharekhan code: CUB

Reco/View: Hold ↔	CMP: **Rs. 126**	Price Target: **Rs. 145** ↓

↑ 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 Updated May 08, 2023				27.63
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

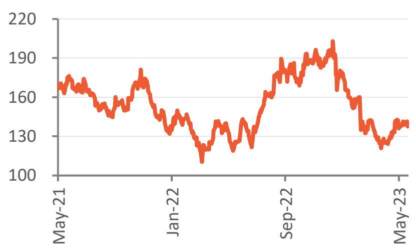
Company details

Market cap:	Rs. 9,307 cr
52-week high/low:	Rs. 205 / 120
NSE volume: (No of shares)	39.6 lakh
BSE code:	532210
NSE code:	CUB
Free float: (No of shares)	71.8 cr

Shareholding (%)

Promoters	-
FII	25.0
DII	36.2
Others	38.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.5	-6.9	-32.8	-1.0
Relative to Sensex	-9.7	-12.6	-33.7	-16.9

Sharekhan Research, Bloomberg

Summary

- We maintain our Hold rating on City Union Bank (CUB) with a revised TP of Rs. 145. Overall, the outlook continues to remain challenging for the bank in FY2024, led by margin pressure, back-ended credit growth, higher stressed assets vs. peers, and sub-optimal PCR in turn higher credit cost.
- Q4FY2023 performance was weak on most fronts – Muted loan growth (up 7% y-o-y/flat q-o-q), sharp NIM decline by 23 bps q-o-q, elevated gross slippages (3.6% annualised based on 12M trailing loans), and credit cost still elevated at 1.6% annualised.
- Operating profit (PPoP) declined by 5% y-o-y/16% q-o-q, led by muted revenue growth (up 1% y-o-y/down 9% q-o-q) despite contained opex growth (up 11% y-o-y/ 3% q-o-q).
- We believe credit cost is expected to remain higher due to higher stressed assets along with sub-optimal coverage and weaker recoveries compared with peers. RoA guidance of about +1.5% in FY2024 looks challenging, and we do not find levers for improvement in business performance in the near term. CUB trades at 1.2x/1.1x its FY2024E/FY2025 ABV, respectively.

City Union Bank (CUB) reported yet another weak quarter. Net interest income (NII) grew mutedly by 3% y-o-y/down 7% q-o-q. Net interest margin (NIM) declined by 23 bps q-o-q to 3.65%. The bank guided that NIMs were negatively impacted by 5-6 bps, led by non-recognition of interest subvention income on agri gold loans and rest of the margin compression was due to higher repricing of deposits. The 15-bps q-o-q increase in loan yields was offset by a ~45 bps increase in cost of deposits. Core fee income grew by 12% y-o-y/10% q-o-q. Treasury income was reported at Rs. 22 crore vs. Rs. 35 crore q-o-q and Rs. 50 crore y-o-y. Total operating expenses grew by 11% y-o-y/3% q-o-q. Operating profit declined by 5% y-o-y/16% q-o-q due to muted revenue growth. Provisions declined by 7% y-o-y/29% q-o-q. Core credit cost stood at 1.6% of average advances during the quarter versus 2.5% in the past quarter. PBT declined by 4% y-o-y/5% q-o-q. PAT reported at Rs. 218 crore was up by 4% y-o-y/ flat q-o-q, led by lower tax rate. Net advances grew by 7% y-o-y/flat q-o-q. Deposits grew by 10% y-o-y/5% q-o-q, with CASA growing at 1% y-o-y/7% q-o-q. CASA ratio stood at 30% vs. 33% y-o-y. Slippages were at Rs. 358 crore (3.6% annualised based on trailing 12-month advances) vs. 4.6% q-o-q and 2.4% in Q4FY2022 coupled with higher recoveries and contained write-offs, which led to better asset quality. GNPA and NNPA stood at 4.37% (down by 25bps q-o-q) and 2.36% (down by 31 bps q-o-q), respectively. The restructured book stood at Rs. 1,255 crore (~2.9% of advances vs. 4.0% of advances sequentially). SMA 2 book stood at 1.8% of advances.

Key positives

- PCR improved to ~47% from ~43% q-o-q.=

Key negatives

- NIM declined by 23 bps q-o-q, led by higher cost of deposits.
- Core credit still higher at 1.6% annualised.
- Loan growth remained muted below system growth.

Management Commentary

- The bank is looking for credit growth in the range of 12-15% y-o-y for FY2024, with a broadly stable loan mix. Growth is expected to remain subdued in H1FY2024 and is expected to pick up in H2FY2024.
- Cost of deposits would remain on a rising trajectory. Thus, the bank has guided for FY2024 NIM to be at similar levels of Q4FY2023, suggesting a ~25bps decline y-o-y.

Our Call

Valuation – Maintain Hold rating with a revised PT of Rs. 145: At the CMP, CUB trades at 1.2x/1.1x its FY2024E/FY2025 ABV. Overall, the outlook continues to remain challenging for the bank in FY2024, led by margin pressure, back-ended credit growth, higher stressed assets vs. peers, and sub-optimal PCR. We believe credit cost is expected to remain higher due to sub-par coverage on bad loans and slippages are expected to remain higher in FY2024E despite muted growth in the past two years and a benign credit cycle. Recoveries are weaker compared with peers. The restructured book is higher than PSU banks also. Business momentum continues to remain below system growth. RoA guidance of about +1.5% in FY2024 looks challenging and we do not find levers for improvement in business performance in the near term.

Key Risks

Stronger loan growth, higher-than-expected margins, fewer slippages, and a subsequent drop in credit cost could lead to upside risk.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
NII	1,916	2,163	2,215	2,379
PAT	760	937	935	1,019
EPS (Rs.)	10.3	12.7	12.6	13.8
P/E (x)	12.2	9.9	10.0	9.2
P/ABV (x)	1.6	1.4	1.2	1.1
RoE (%)	12.2	13.4	11.8	11.4
RoA (%)	1.3	1.5	1.3	1.3

Source: Company; Sharekhan estimates

Key Results Highlights

- **Margin to remain under pressure:** NII grew mutedly by 3% y-o-y/down 7% q-o-q. NIM declined by 23 bps q-o-q to 3.65%. The bank guided that NIM was negatively impacted by 5-6 bps, led by non-recognition of interest subvention income on agri gold loans and rest of the margin compression was due to higher repricing of deposits. The 15 bps q-o-q rise in loan yields was offset by a ~45 bps increase in cost of deposits. The bank has guided that 45-50% deposits have been repriced and, thus, the cost of deposits would remain on a rising trajectory. The bank has guided for FY2024 NIM to be at similar levels of Q4FY2023, suggesting a ~25 bps decline y-o-y.
- **Credit growth outlook:** Advances grew at a muted rate by 7% y-o-y/flat q-o-q below system growth. The bank is looking for credit growth of 12-15% y-o-y for FY24, with a broadly stable loan mix. Growth is expected to remain subdued in H1FY2024 and is expected to pick up in H2FY2024.
- **Weak CASA franchise:** Total deposits grew by 10% y-o-y/5% q-o-q, with CASA growing at 1% y-o-y/7% q-o-q. CA and SA balance increased by 19% and 3% q-o-q, respectively. CASA ratio stood at 30% vs. 33% y-o-y. Term deposits grew by 14% y-o-y/4% q-o-q. LD ratio stood at 82% vs. 86% in the last quarter.
- **Credit cost:** Core credit cost stood at 1.6% of average advances during the quarter versus 2.5% in the past quarter. The bank has not given any guidance on credit costs going forward. The bank said that it would be dependent on the level of PCR (or net NPAs). The current outstanding of Spice Jet is at Rs. 25 crore. In June 2023, the final installment will be received and the bank currently holds 100% provisions against the same account.
- **Asset quality:** GNPA ratio declined by 25 bps q-o-q to 4.37% and NNPA ratio fell by 31 bps q-o-q at 2.36%. PCR increased to 47% vs. 43% q-o-q. The restructured book stood at Rs. 1,255 crore (~2.9% of advances vs. 4.0% of advances sequentially). Gross slippages were at Rs. 358 crore vs. Rs. 439 crore q-o-q. Upgrades and recovery amounted to Rs. 290 crore vs. Rs. 173 crore q-o-q. Write-offs were at Rs. 137 crore vs. Rs. 139 crore in the past quarter. SMA-2 book stood at 1.8% of advances and is at the bank's historical low. The bank expects moderation in slippages along with better recoveries in FY2024. NNPAs are expected to be back to pre-Covid levels in the next 4-5 quarters.
- **Others:** BCG tie-up will help the bank in business re-engineering, including risk measurement, modelling of portfolio, digital lending, sanction, and customer experience.

Results (Standalone) **Rs cr**

Particulars	Q4FY23	Q3FY23	Q4FY22	Y-o-Y %	Q-o-Q %
Interest Income	1,228	1,206	1,050	17	2
Interest Expenses	714	650	549	30	10
Net Interest Income	**514**	**556**	**501**	**3**	**-7**
NIM (%)	3.65	3.88	4.01		
Core fee income	89	80	79	12	10
Other Income	107	144	124	-14	-26
Net Operating Revenue	**709**	**780**	**704**	**1**	**-9**
Employee Expenses	130	127	114	14	2
Other Opex	163	156	150	8	4
Total Opex	**292**	**283**	**264**	**11**	**3**
Cost to Income Ratio (%)	**41.2%**	**36.2%**	**37.5%**		
Pre Provision Profits	**417**	**497**	**440**	**-5**	**-16**
Provisions & Contingencies - Total	159	225	171	-7	-29
Profit Before Tax	**258**	**273**	**269**	**-4**	**-5**
Tax	40	55	60	-33	-27
Effective Tax Rate (%)	15.5	20.2	22.3		
Reported Profits	**218**	**218**	**209**	**4**	**0**
Basic EPS	3.0	2.9	2.8	4	0
Diluted EPS	2.9	2.9	2.8		
RoA (%)	1.3	1.3	1.4		
Advances	43,053	43,009	40,358	7	0
Deposits	52,398	49,997	47,690	10	5
Gross NPA	1,920	1,989	1,933	-1	-3
Gross NPA Ratio (%)	4.37	4.62	4.70		
PCR - (%)	47.0	43.5	38.4		
Net NPA	1,018	1,124	1,191	-15	-10
Net NPAs Ratio (%)	2.36	2.67	2.95		

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector Outlook – Deposit mobilisation to remain in focus; banks with a superior liability franchise placed better**

System-level credit offtake grew by ~15.5% y-o-y in the fortnight ending May 5, 2023, while deposits rose by ~10.4% but still trail advances growth. In the past 2-3 years, loan growth was driven majorly by retail loans and, off lately, we have seen MSME and SME loan offtake picking up. Corporate loan growth has been sluggish. The RBI has taken a pause in rate hikes as of now. In this backdrop, we believe credit to large industries/corporates is expected to pick up gradually, driven by capex-led demand. However, we should see some moderation in loan growth due to a higher base going forward, partially offset by pick-up in corporate loan growth, but loan growth is expected to remain healthy. Margin improvement is likely to end by Q1FY2024. Margin pressure, if any, due to the sharp repricing of deposits is expected to get offset by opex growth moderation. Asset quality is not a concern right now, as corporate lending has been muted in the past few years. From the retail and MSME side, there could be some pressure due to an adverse macro situation if any, but nothing is significant. Asset-quality outlook remains stable to positive for the sector in the near to medium term. We believe there would be tactical market share gains for well-placed players. Banks with a robust capital base, strong retail deposit franchise, and with high coverage and provision buffers are well placed to capture the new credit growth cycle.

■ **Company Outlook – Weak performance despite strong sector tailwinds**

We believe credit cost is expected to remain higher due to sub-par coverage on bad loans and slippages are expected to remain higher in FY2024E despite muted growth in the past two years and benign credit cycle. Recoveries are weaker compared with peers. The restructured book is higher than PSU banks also. Business momentum continues to remain below system growth.

■ **Valuation – Maintain Hold rating with a revised PT of Rs. 145:**

At the CMP, CUB trades at 1.2x/1.1x its FY2024E/FY2025 ABV. Overall, the outlook continues to remain challenging for the bank in FY2024, led by margin pressure, back-ended credit growth, higher stressed assets vs. peers, and sub-optimal PCR. We believe credit cost is expected to remain higher due to sub-par coverage on bad loans and slippages are expected to remain higher in FY2024E despite muted growth in the past two years and a benign credit cycle. Recoveries are weaker compared with peers. The restructured book is higher than PSU banks also. Business momentum continues to remain below system growth. RoA guidance of about +1.5% in FY2024 looks challenging and we do not find levers for improvement in business performance in the near term.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
City Union Bank	126	9,307	10.0	9.2	1.2	1.1	11.8	11.4	1.3	1.3
AU Small Finance Bank	790	52,705	29.5	23.1	4.2	3.6	15.0	16.4	1.8	1.9

Source: Company, Sharekhan estimates

About company

CUB was founded in October 1904 and is headquartered at Kumbakonam, Tamil Nadu, 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 752 branches, of which ~88% are in South India with ~74% business coming from Tamil Nadu. The bank focuses on the niche segment of working capital financing to MSMEs and traders. The bank has a comfortable capital position with CRAR of 22.34%, of which Tier-1 constitutes 21.27%.

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. Several smart business decisions of the management such as staying away from consortium-based lending and scaling back segments, where initial stress was seen, have served it well. However, the bank has not fully recovered from pandemic-related stress and its restructured book continues to remain higher than some of the PSU banks. Additionally, recent internal control lapses appear as red flags.

Key Risks

Higher loan growth, higher-than-expected margins, fewer slippages, and a subsequent drop in credit cost could lead to upside risk.

Additional Data

Key management personnel

Mr. M. Narayanan	Chairman
Dr N. Kamakodi	MD & CEO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	CAPITAL GROUP COS INC LTD.	5.97
2	SMALLCAP WORLD FUND INC.	4.94
3	HDFC ASSET MANAGEMENT CO. LTD	4.52
4	SBI FUNDS MANAGEMENT LTD.	4.04
5	FRANKLIN RESOURCES LTD.	3.79
6	AXIS ASSET MANAGEMENT CO. LTD.	2.87
7	CANARA ROBERO ASSET MANAGEMENT CO. LTD.	2.82
8	LIFE INSURANCE CORP OF INDIA	2.33
9	ICICI Prudential AMC LTD	2.26
10	VAIDYANATHAN VILASINI	2.04

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

Sharekhan

by BNP PARIBAS

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/ investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600