

CITY UNION BANK LTD

(CUB)

Initiating Coverage

Rating: **BUY** (Target Price: Rs 205)



Driving retail growth with digital momentum

We initiate coverage on City Union Bank (CUB) with a “BUY” recommendation and a target price of Rs 205, valuing the bank at 1.5x of its FY26E Adj. BV. We believe that the bank is moving in the right direction so as to grow its retail segment. The growth in retail segment is expected to be the key catalyst in achieving double-digit growth target. Also, its margins are expected to improve as CUB moves towards retail segment lending. The bank is transforming its operations with regards to its credit assessment, underwriting, loan disbursement, sanctioning and collection mechanism. CUB is also looking to expand its footprint within Tamil Nadu and other southern states with the plan to increase its branch count by 75. It plans to focus on urban regions, going forward, which shall drive higher CASA deposits and eventually improve its CASA ratio. Its asset quality has shown improvement in the last two years, thereby reducing slippages and increasing recoveries.

Rundown of KCC loans and partnering with NBFCs: The bank has significantly reduced its KCC loan book due to which there was a de-growth in the agriculture segment till Q3FY24. However, the bank saw an increase of 19.5% QoQ, indicating growth in other segments. The bank’s plan for partnerships with NBFCs helps in two ways -- Increase CUB’s reach, scale its business operations, diversify risks and co-lend for vehicles, gold and housing segment. The bank expects double-digit growth in collaboration with NBFCs, which shall further boost overall credit growth.

Management interaction outcome: We interacted with the management of the bank, which remained positive of achieving its loan growth guidance of 12–15% in FY25E. The CUB management expects its margins to improve to 4% by FY5E (implying, 40bps improvement from FY24 NIM). The bank has collaborated with Boston Consulting Group (BCG) for digitally processing loans, improving loan underwriting practices, formulating a credit hub technology. CUB has deployed Newgen software for credit underwriting and other core processes. The average ticket size of the loan is in the range of Rs 7.5mn–10mn. The management is looking to expand beyond Tamil Nadu and planning to expand in other southern states as well.

Valuation and outlook: City Union Bank is trading at a one-year forward P/Adj. BV valuation of 1.3x. The bank has revamped its strategy to focus more on retail lending, which would lead to higher NIMs. CUB expects its loan growth to be in double digits as compared to single-digit growth in the last two financial years (FYs). It anticipates that margins will be restored to the pre-COVID-19 level of 4% (implying an improvement of 40bps from FY24 NIMs). CUB has announced branch expansion in urban areas of southern states, which shall aid in the improvement of its CASA ratio. With the loan book growth of 10%/14.7% in FY25E/FY26E and margin at 4% in FY26E, we estimate its NII/PAT to expand at a CAGR of 17.3%/14.2% over FY24–26E. We value its FY26E P/Adj. BV at 1.5x to arrive at a target price of Rs 205 (upside of 23%) and initiate coverage with a **BUY** rating.

YE March (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Net interest income	19,165	21,628	21,235	24,921	29,199
Pre-provision operating profit	15,953	18,180	15,167	17,471	20,355
Profit after tax	7,602	9,375	10,157	11,444	13,394
EPS (Rs)	10.3	12.7	13.7	15.5	18.1
Adj. BVPS (Rs)	72.9	87.0	101.3	120.4	138.9
Net interest margin (%)	4.0	3.9	3.6	3.8	4.0
P/E (x)	16.6	13.5	12.5	11.1	9.5
P/Adj. BV (x)	2.3	2.0	1.7	1.4	1.2

Source: Company, ACMIIL Research

CITY UNION BANK LTD

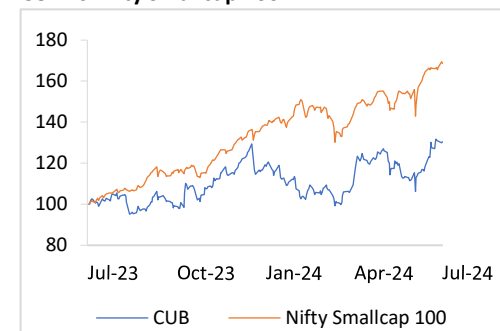
Key Data	
Bloomberg code:	CUBK:IN
Target price (₹)	205
CMP (₹)	170
Upside/ (Downside)	20.5%
Rating:	BUY
Shares outstanding (mn):	741
Mcap (Rs bn) :	126
52-week H/L (Rs):	172/120

Price Performance (%)	
1 month	13%
3 months	15%
12 months	31%

Shareholding Pattern (%)			
	Sep-23	Dec-23	Mar-24
Promoter	-	-	-
FII	23.7	26.6	27.0
DII	33.2	32.4	29.5
Public	43.2	41.0	43.6
Pledge	-	-	-

Sources: BSE

CUB vs Nifty Smallcap 100



Source: NSE

Analysts

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Company overview

City Union Bank is a regionally-focused, mid-sized, private sector bank headquartered in Tamil Nadu. It has 800 branches with a strong presence in southern India (692 branches), of which 524 are in Tamil Nadu's semi-urban regions (as of FY24). Being geographically concentrated, it has a market share of 0.3% (in advances and deposits) in the banking industry. The bank has a stable customer base, which has built over time.

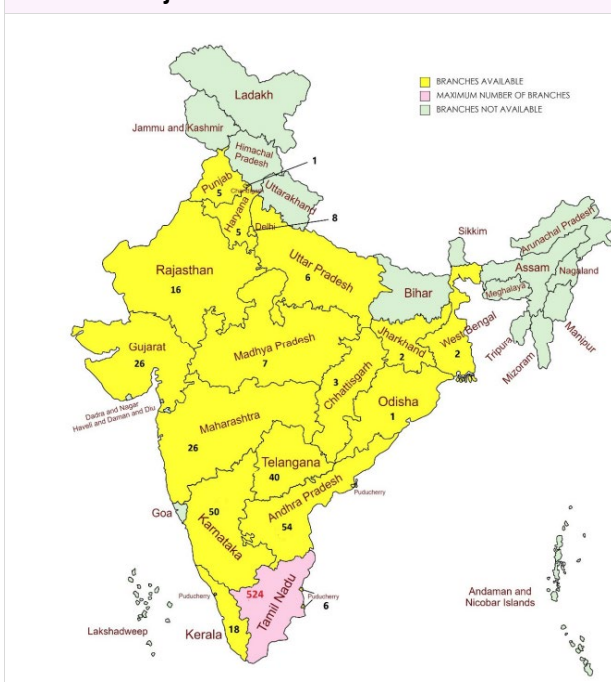
Its key segments include lending to the MSME segment, retail/wholesale lending and lending in agri sector. It also lends to large industries, gives home loans, gold loans and other. The bank has established a retail franchise and is seeing growth in its key segment such as MSME, retail and agri segments. The bank has seen healthy growth of ~15% in its retail segment in the last three years, which is expected to drive growth, going forward. The bank is focused on increasing its retail franchise and we expect to see a spike in its retail lending segment.

A high proportion of CUB's loans is secured lending (99% of the loan book). It has seen improvement in its asset quality over the last five years with declining slippages as the loan constituents change. Historically, its deposits have expanded at a CAGR of 8.1% over FY20–24 while advances have reported a growth of 7.7% over the same period. The bank is on the path to achieve double-digit growth, which is possible as it has reported healthy growth in its retail book with the completion of rundown of KCC loans.

The bank is led by promoters who have a long history of adhering to stable underwriting practices and sustaining through business cycles. The management has inherent expertise in MSME lending, which forms the highest portion of its loan book. The bank has established strong underwriting practices, which are expected to keep its asset quality intact and cash flows predictable. The bank remains sufficiently capitalised to fund future growth and has guided mid double-digit loan growth in FY25E.

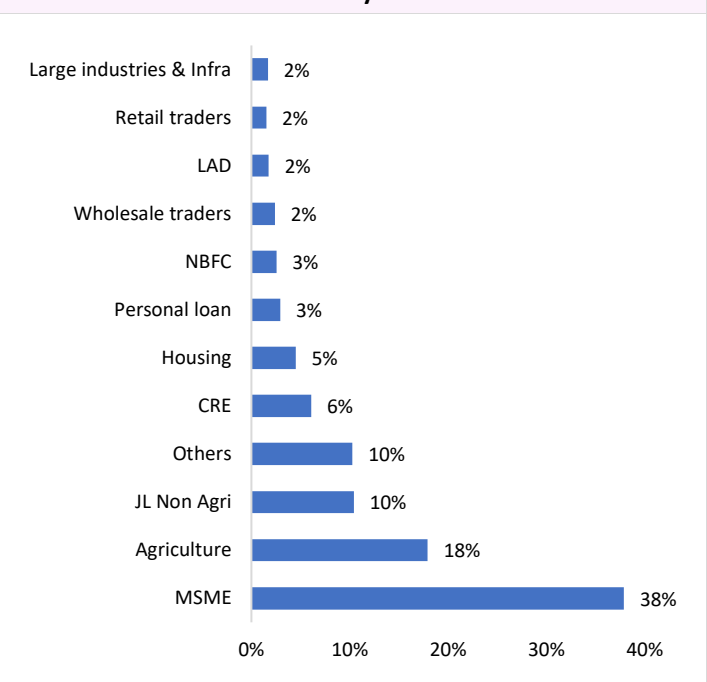
The bank has a special approach for small and medium-sized businesses, targeting a large, untapped market in the southern India. Its customer-centric approach helps it to retain its clients and keep costs low when getting new business. The bank is setting up a new sales vertical for secured lending, such as home loans and LAP. CUB is also looking forward to opportunities of collaboration along with certain NBFCs where the bulk of lending is happening in gold loans and vehicle financing. The bank has now shifted its focus to digital lending so as to enhance user experience by reducing the TAT of loan disbursement.

Exhibit 1: Major concentration of branches in Tamil Nadu



Source: Company, ACMIIL Research

Exhibit 2: Asset allocation of City Union Bank



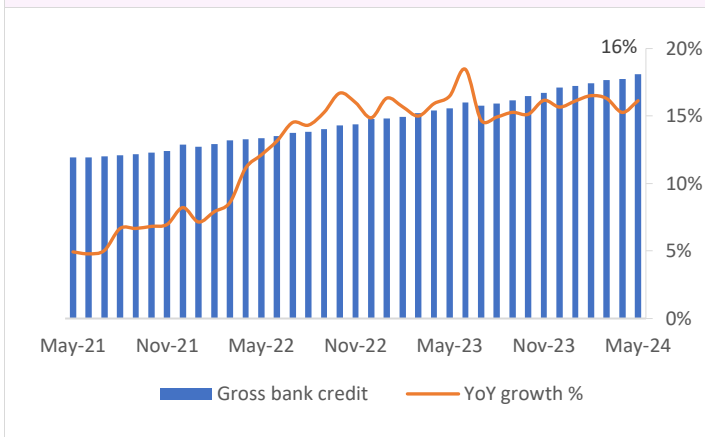
Source: Company, ACMIIL Research

Healthy credit growth in banking system as interest rates stabilises

The systematic increase in bank credit remains healthy after COVID-19 subsided. Banks continue to see healthy growth momentum vis-a-vis its historical average. The credit growth is mainly backed by retail and MSME segments. Growth in private sector banks remains higher than the public sector banks. Credit growth in the MSME segment (especially micro and small enterprises) and agri loans continue to exceed the industry average. Upbeat consumer demand, growth in business profitability and easy access to credit shall continue to drive growth. Acceleration in deposits shall also act as a catalyst for credit growth for banks. The banking sector is expected to see a credit growth of ~14% in FY25E (Source: Crisil ratings). While retail credit is anticipated to grow by 16% in the same period, corporate credit is forecast to grow by 13%. The personal loan segment shall continue to outgrow other retail segment, which will drive credit growth. The key catalyst for growth remains intact while revival in corporate credit in H2FY25E could act as a tailwind.

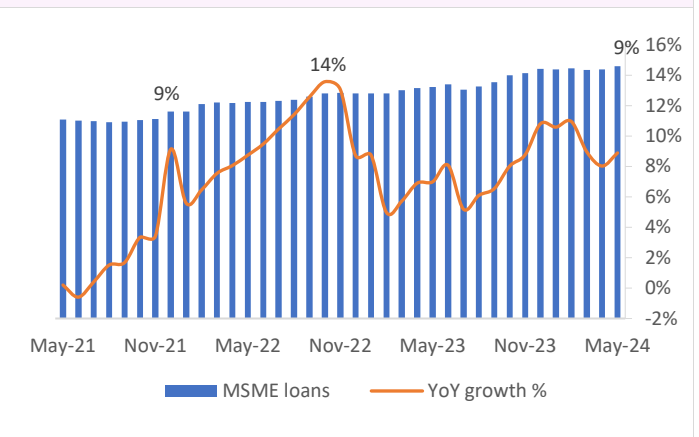
The growth outlook remains strong for segments, such as MSME, agri loans and gold loans in FY25E as these segments continue to see demand from semi-urban and rural regions. Also, advances against fixed deposit receipts (FDRs) segment saw a spurt during the pandemic. However, after COVID-19 subsided, moderation was witnessed in advances against FDRs. Interest rates (MCLR) have stabilised as opposed to the rising trend last year. Such stabilised interest and interest rate cut in the near future can further stimulate the credit demand in the system.

Exhibit 3: Banks credit growth continues to be healthy



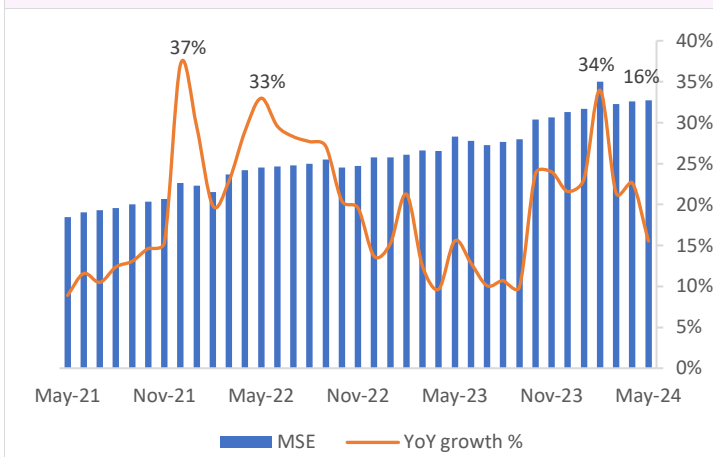
Source: RBI

Exhibit 4: MSME lending dragged down by large entities



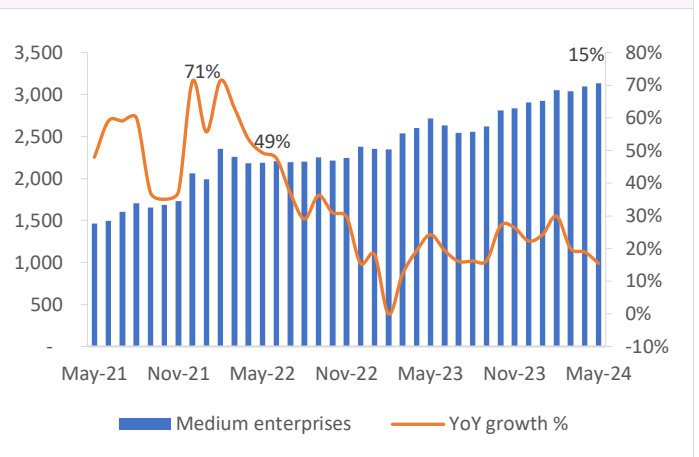
Source: RBI

Exhibit 5: Strong uptick in micro and small enterprises loans



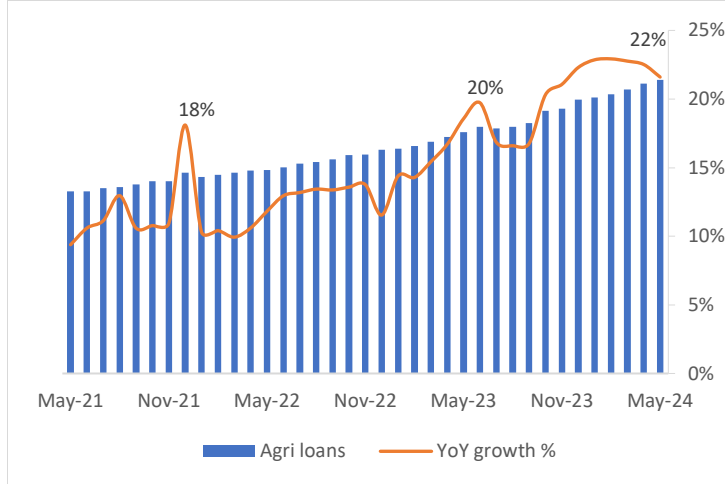
Source: RBI

Exhibit 6: Medium enterprise lending is seeing moderation



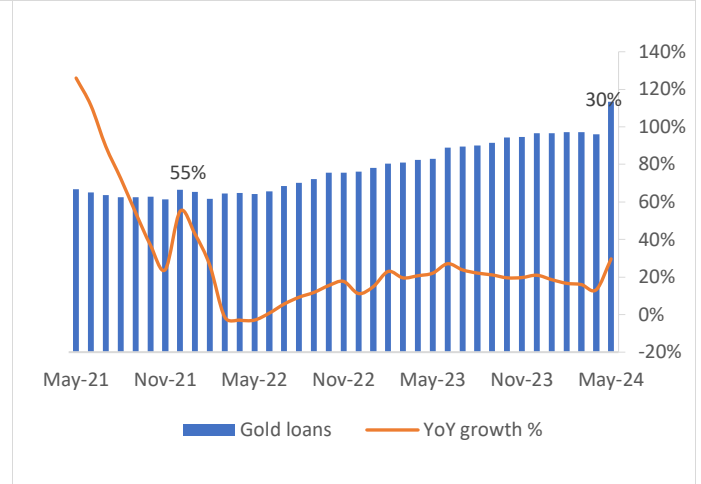
Source: RBI

Exhibit 7: Demand for agri lending remains strong



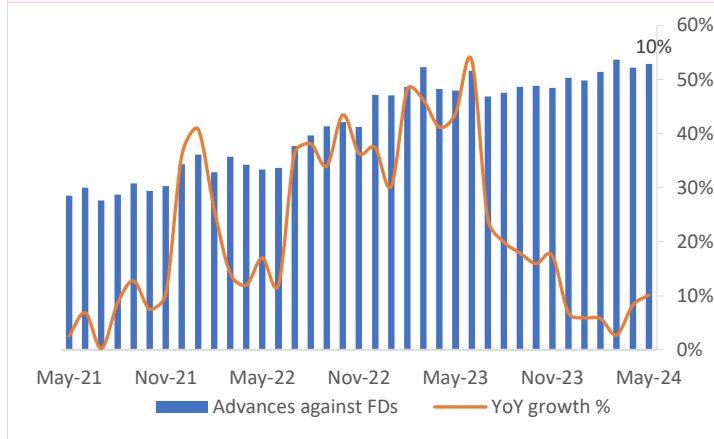
Source: RBI

Exhibit 8: Traction in gold lending segment



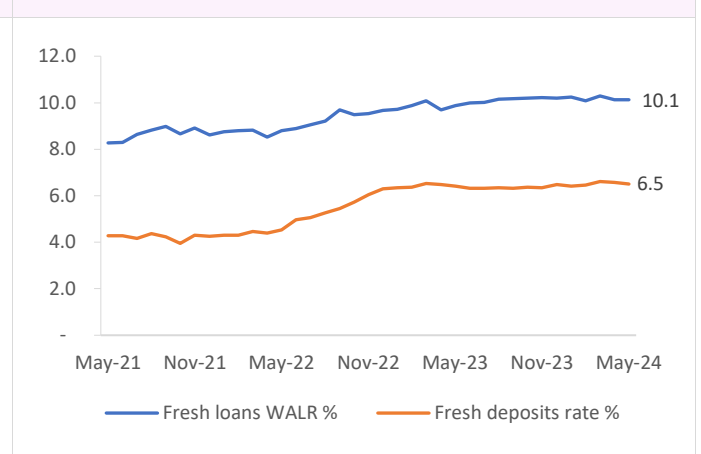
Source: RBI

Exhibit 9: Advances against FDs is seeing moderation post COVID-19



Source: RBI

Exhibit 10: Stabilisation in interest rates



Source: RBI

MSME-focused lending pivoting towards retail lending

City Union Bank has been an MSME-focused lending bank owing to its inherent expertise and relationships in the segment. The bank also has a high portion of agri loans and lends to joint lending groups. Since the bank has a major presence in the semi-urban and rural regions, it serves the micro-finance segment with the aim of financial inclusion. The bank has the highest proportion of secured lending in its loan book (99% of the lending is secured in nature). The banks aim to increase its unsecured lending in the long run in the retail loan segment.

Increase in focus on retail lending

Going forward, the bank aims to increase its focus on retail lending through housing loans and loans against property (LAP) segment. At present, housing loans form ~5% of its loan book, which is expected to inch upwards. In March 2024, the appointment of Mr. R. Vijay Anandh, an expert in the retail segment, demonstrates City Union's intent to increase its lending in retail segment. The bank's push in this segment is well-supported by growth in the overall retail segment of the industry and tailwinds in the house lending segment. CUB looks to target both, salaried and self-employed customers, depending on their risk profiles. It looks to tap its existing loan customer base for retail credit underwriting. After this, City Union Bank shall look to leverage its retail deposits' base for new loans in the housing and LAP segment. The company looks to have a retail setup, such as a DSA, for the disbursement of its loans. For the first time, the bank has built a sales vertical for its retail business. It has identified senior management professionals to restructure its focus on retail lending. The bank shall also look to use digital analytics tools for loan underwriting, credit quality assessment

and disbursement of loans. In the long term, City Union Bank also plans to increase the portion of unsecured lending in its loan book, which shall improve margins and eventually get a foothold in this segment.

Taking steps for the future

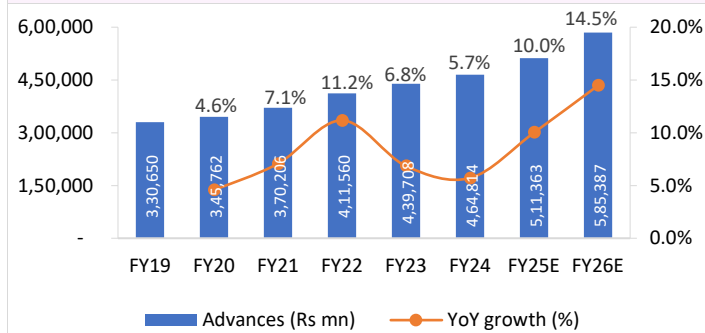
With the purpose of increasing its footprint in the retail lending segment and expand geographically, the bank has taken digital initiatives to ensure proper underwriting practices and see growth in the segment. The bank has appointed BCG to upgrade its digital lending process. City Union Bank expects to see a direct impact of the digital initiatives on its bottom line in the next few quarters. The bank expects to see an acceleration in its loan book. The digitised process shall improve its TAT for the bank, leading to higher efficiency of its operations. As a result of digitisation, the lending TAT reduced, from 7–15 days earlier to 1–2 days lately. Digital lending was undertaken primarily for retail loans but the bank will implement it for MSME lending too. In the long run, it will use the process for unsecured lending as well.

Decline in KCC loans and partnerships with NBFCs

City Union Bank has significantly reduced its KCC loan book due to which there was de-growth in the agriculture segment till Q3FY24. However, the bank saw an increase of 19.5% QoQ in agri book, indicating growth in other segments. Lower ticket size in the agri segment and increase in NPA were the two factors which forced the bank to run down its KCC lending. The bank’s plan for partnerships with NBFCs helps in two ways -- Increase CUB’s reach, scale its business operations, diversify risks and co-lend for vehicles, gold and housing segment. The bank expects double-digit growth in collaboration with NBFCs, which shall further boost overall credit growth.

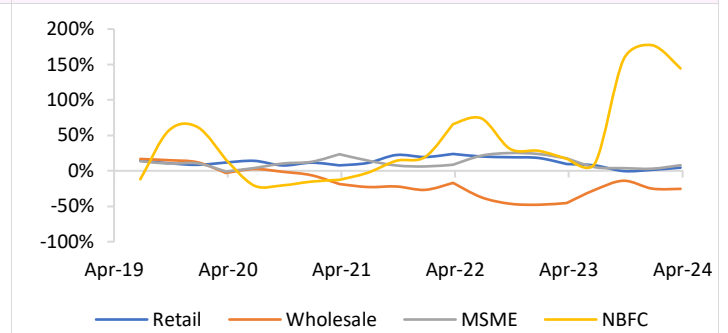
The bank has seen an accelerated rate of growth in lending to NBFCs. The bank expects to continue to remain in the secured lending business. The management has guided the growth of 12–15% in FY25E, which seems achievable. We expect loan growth of 11.5%/12.5% in FY25E/26E, factoring in the management guidance and an increase in the retail segment.

Exhibit 11: Advances expected to see double digit growth



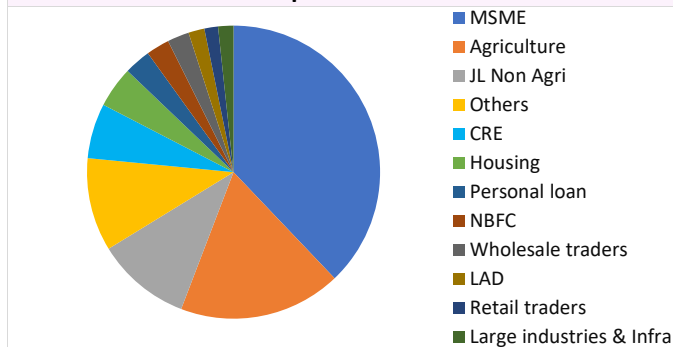
Source: Company, ACMIIL Research

Exhibit 12: Retail and NBFC lending has contributed to growth



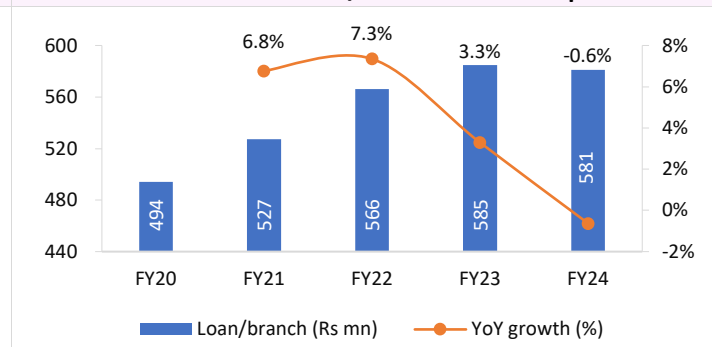
Source: Company, ACMIIL Research

Exhibit 13: CUB advances portfolio



Source: Company, ACMIIL Research

Exhibit 14: Moderation in loan/branch due to competition

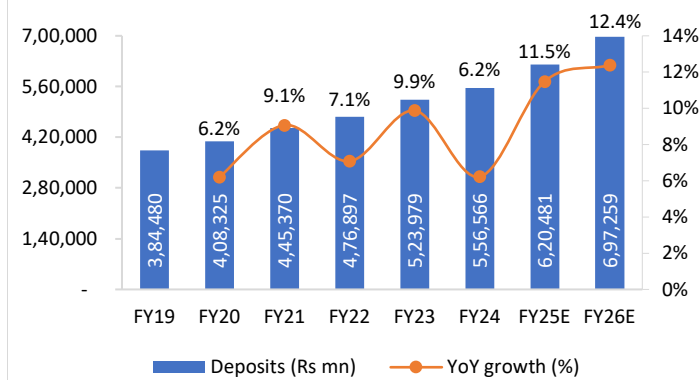


Source: Company, ACMIIL Research

Deposits expected to pickup

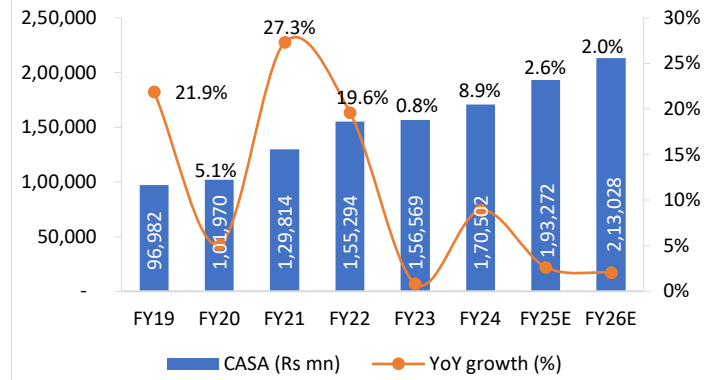
The bank has, historically, seen moderate growth in its deposits. Its CASA ratio has remained low as compared to the industry average. Therefore, the bank is majorly dependent on borrowings for funding its loans. CASA ratio is expected to grow as the bank plans to leverage its retail deposits franchise. The bank has hired professionals and put in place processes so as to enable deposit growth in line with its peers. We believe that deposits will pick up pace in FY25E as the bank has high deposit rate as compared to its peers. Deposits have grown at 8.1% CAGR over FY20–24, but we expect them to accelerate to double digits and grow by 12% CAGR over FY24–26E. We expect that City Union Bank’s foray into retail lending and digital initiatives could benefit deposit growth, going forward, which will keep its cost of funds under check.

Exhibit 15: Deposits growth led by term deposits



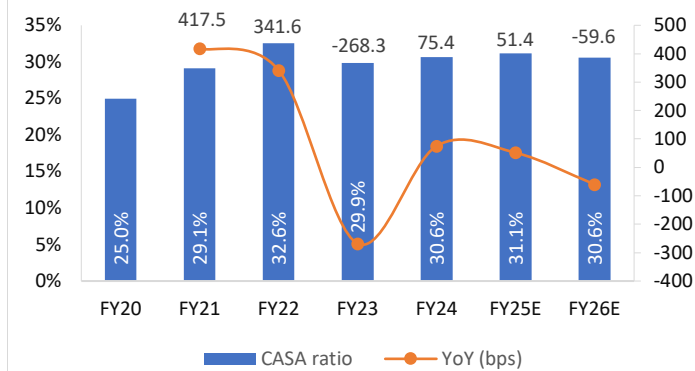
Source: Company, ACMIIL Research

Exhibit 16: CASA deposits expected to remain in single digits



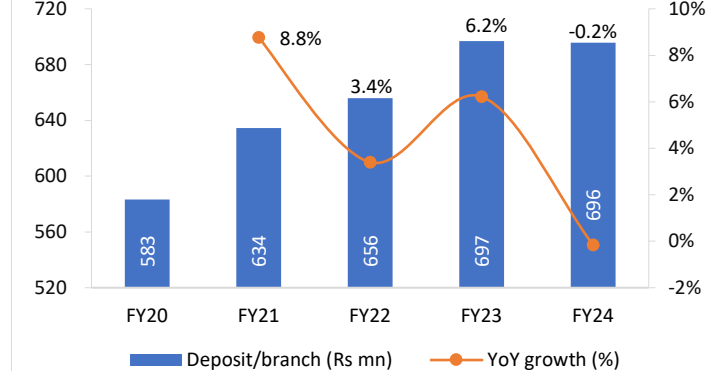
Source: Company, ACMIIL Research

Exhibit 17: CASA expected to remain range-bound



Source: Company, ACMIIL Research

Exhibit 18: Moderation in deposit/branch in FY24

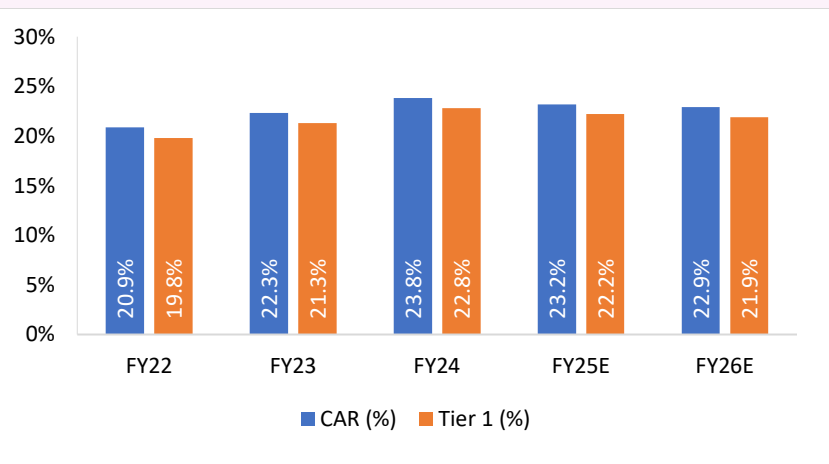


Source: Company, ACMIIL Research

Adequate capital for future buffers

The bank has a comfortable capital position. As of March 2024, the common equity tier 1 ratio and the overall capital adequacy ratio (CAR) stood around 23.8% and 22.8% respectively. The CAR of CUB is much higher than the required RBI mandate of 11.5%. The recent RBI regulation on higher risk weights for unsecured consumer loans, including credit cards and loans to NBFCs above a certain limit, is expected to have little impact on the bank’s capital ratios. The bank’s strong capital position will act as a cushion against the expected slippages from the stressed book over the near-to-medium term.

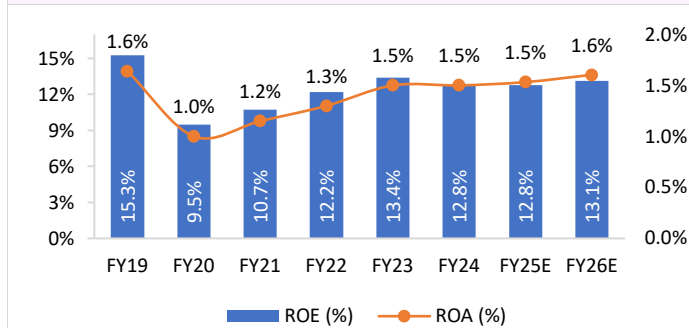
Exhibit 19: CAR and Tier 1 capital above regulatory requirement of RBI



Source: Company, ACMIIL Research

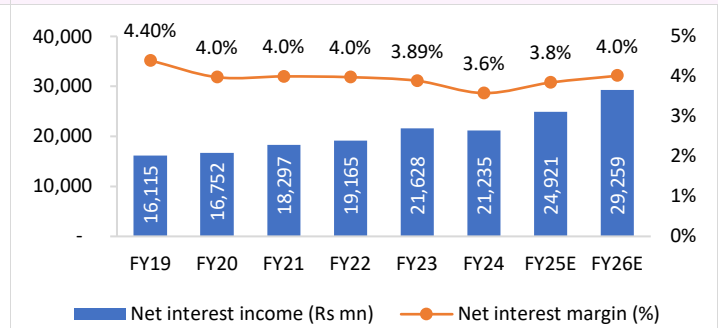
Ratio analysis

Exhibit 20: Expansion in RoA/RoE as profitability increases



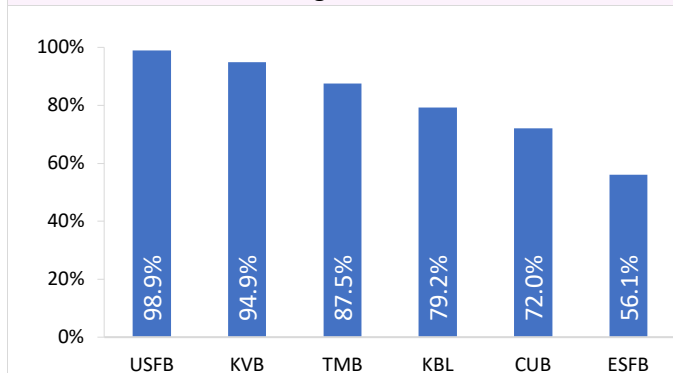
Source: Company, ACMIIL Research

Exhibit 21: Improvement in margin leading to growth in NII



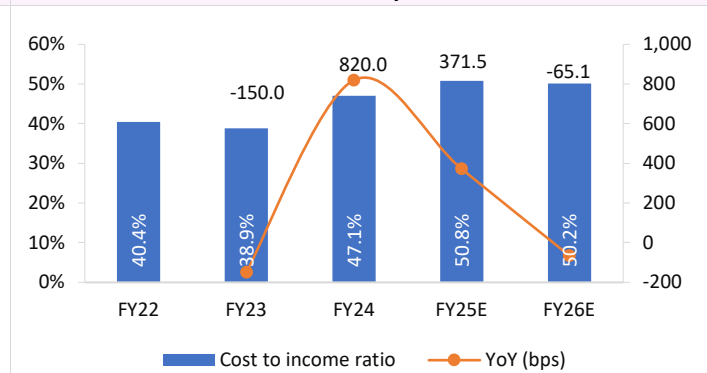
Source: Company, ACMIIL Research

Exhibit 22: Provision coverage of CUB remains lower



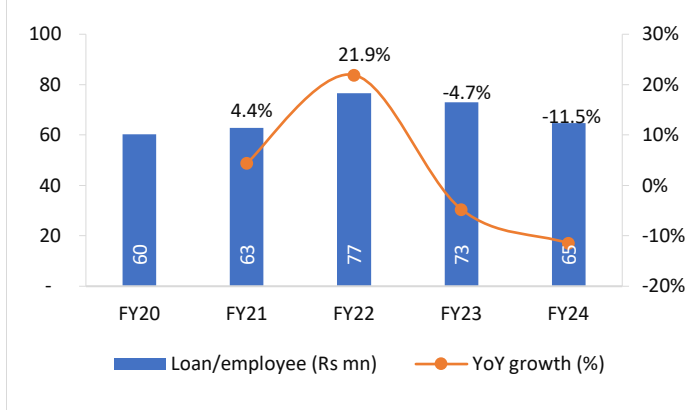
Source: Company, ACMIIL Research

Exhibit 23: Cost-to-income ratio expected to moderate in FY26E



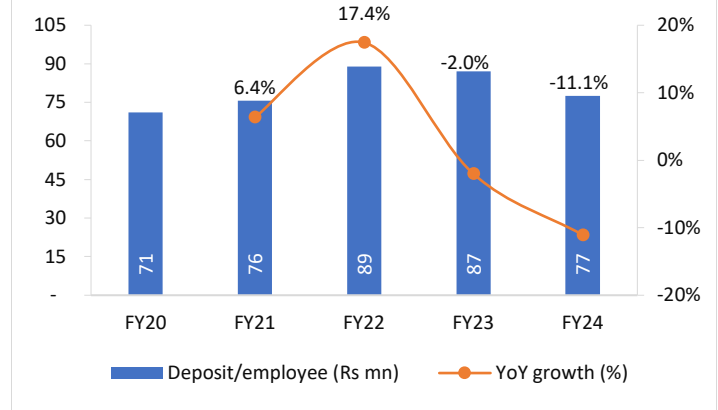
Source: Company, ACMIIL Research

Exhibit 24: Loan/employee declined in the last 2 FYs



Source: Company, ACMIIL Research

Exhibit 25: Decline in deposit/employee in the last 2 FYs

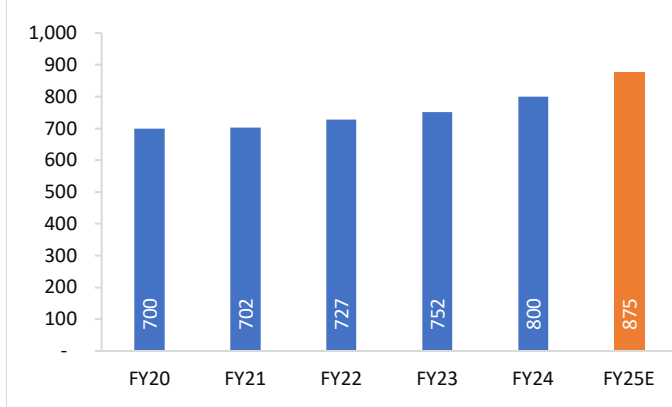


Source: Company, ACMIIL Research

Branch expansion strategy

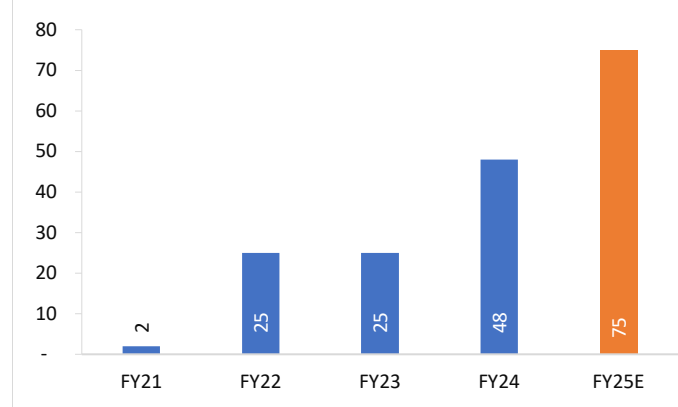
Being a regionally-concentrated bank, CUB has 74% of its branches in southern India (~66% in Tamil Nadu). The bank plans to expand its reach by – 1) Increasing the number of branches (guidance of 75 branches in FY25 as compared to 48 branches in FY24), 2) Increase in its digital footprint. 3) Collaboration agreements with NBFCs. The bank has established branches as well as DSAs to grow its reach. These branches are located in semi-urban and rural areas. Hence, an increase in the number of branches shall help in deeper penetration in these markets and a better understanding of the MSME and retail segments. CUB looks to expand in other southern states while collaborating with other NBFCs. It is in the final stages of MSME lending via digital mode while it seeks to expand online with digital lending in the retail segment. Full implementation of this digital lending strategy is expected to begin in Q2FY25.

Exhibit 26: Branch count to reach up to 875 in FY25



Source: Company, ACMIIL research

Exhibit 27: Bank plans to add 75 branches in FY25

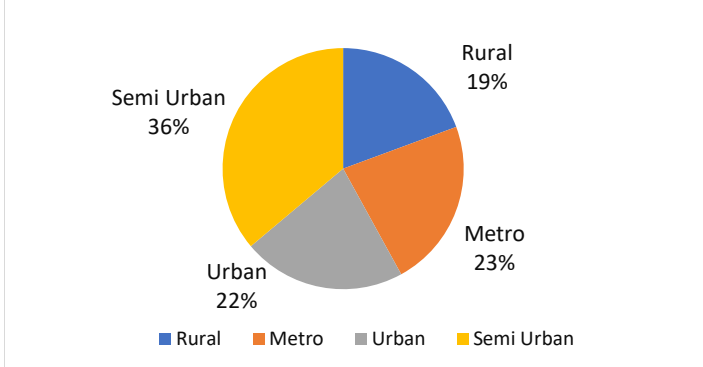


Source: Company, ACMIIL Research

State	No. of Branches	% of Deposits	% of Advances	% of Business
Tamil Nadu	524	80%	66%	74%
Andhra Pradesh	54	2%	7%	5%
Karnataka	50	7%	5%	6%
Telangana	40	3%	6%	4%
Maharashtra	26	3%	4%	3%
Gujarat	26	1%	3%	2%
Kerala	18	1%	2%	2%
Rajasthan	18	1%	2%	1%
Others	46	2%	5%	3%

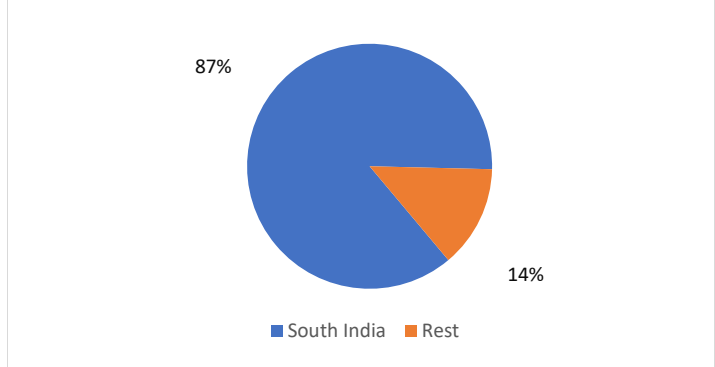
Source: Company

Exhibit 28: Most of the bank branches are located in semi-urban regions



Source: Company, ACMIIL research

Exhibit 29: High concentration of branches in southern India



Source: Company, ACMIIL research

Asset quality continues to improve

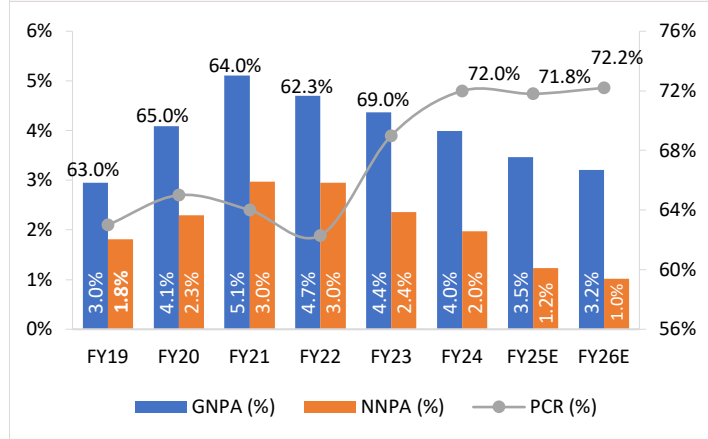
The bank's strict customer profile assessment has resulted in significant enhancement in its asset quality. In the aftermath of COVID-19 pandemic, the bank implemented stricter profile evaluation so as to keep a check on its NPAs. During the pandemic, the approval rate was around 50%–60%, which dropped to 25%–30% post-COVID-19. However, the bank is gradually improving its approval rate, which is expected to return to 50% once digitisation is completed.

The bank's gross NPA has decreased to 3.99% in FY24, down from 4.47% in FY23 and 4.91% in FY22. Similarly, the net NPA has dropped below the 2% mark, from 2.95% in FY23 to 1.97% in FY24. This improvement is attributed to the bank's successful NPA recoveries, which surpassed new slippages. For FY24, total slippages were Rs 10,130mn as compared to Rs 12,760 mn in FY23, with recoveries to the tune of Rs 10,310mn.

This trend of higher recoveries over slippages has led to a consistent reduction in NPAs over the last three quarters from Q2FY24 to Q4FY24. As a result, the bank's improved gross and net NPA numbers will help lower its credit cost leading to improvement in its provisions. As the bank continues to refine its credit assessment processes, it anticipates further improvement in asset quality.

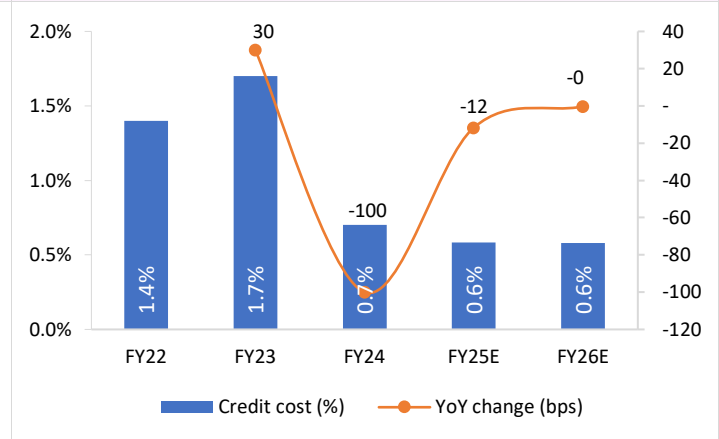
Going ahead, the asset quality is expected to further improve, given that the bank is now focusing on retail lending. With granular nature of loans in the retail segment, the expectation going ahead is for the net NPA to reduce to the level of around 1%–1.25%. Accordingly, by FY26, we expect the net NPA to remain around a similar level of 1% while slippages to be around 2%.

Exhibit 30: GNPA/NNPA is expected to moderate



Source: Company, ACMIIL research

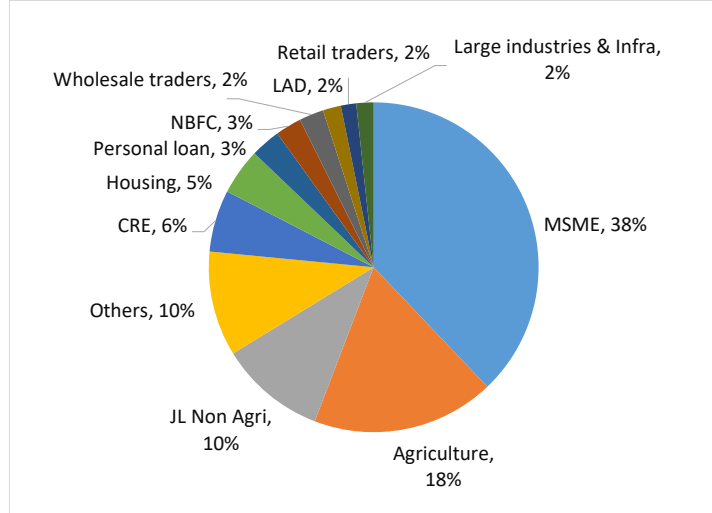
Exhibit 31: Credit is expected to remain at current level



Source: Company, ACMIIL research

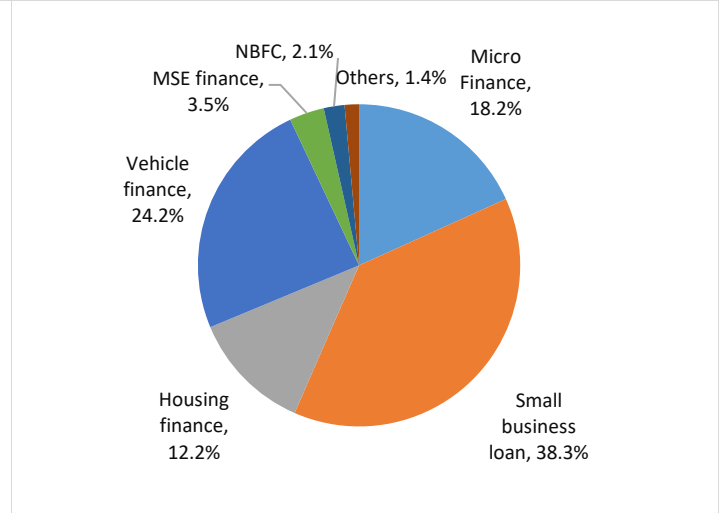
Peer comparison

Exhibit 32: CUB loan book classification



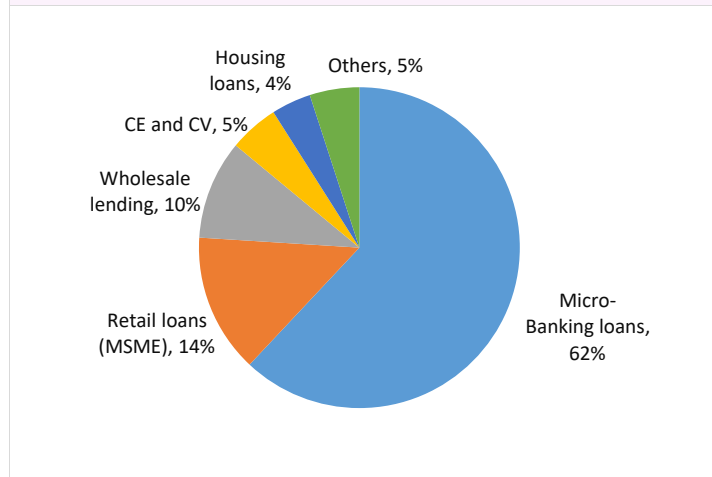
Source: Company, ACMIIL research

Exhibit 33: ESAF SFB has high share of small business loan



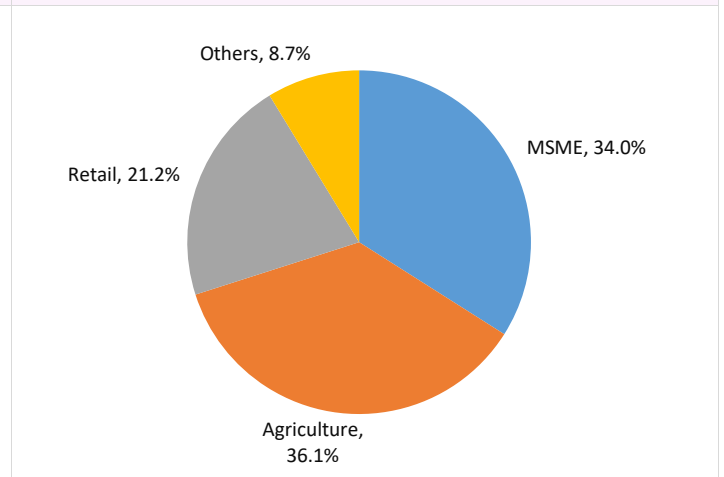
Source: Company, ACMIIL research

Exhibit 34: Utkarsh SFB lends majorly in micro-finance segment



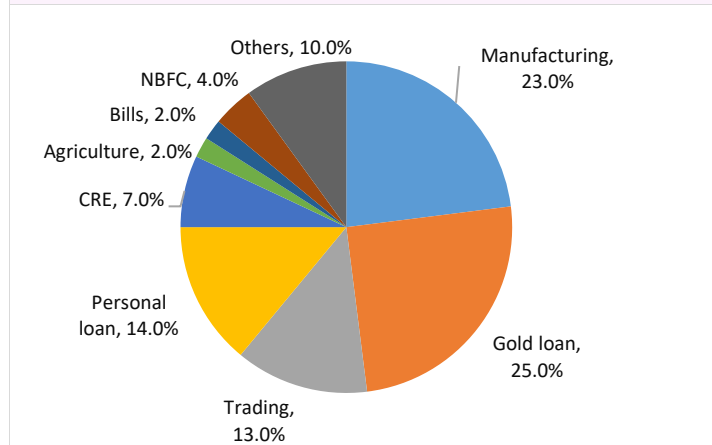
Source: Company, ACMIIL research

Exhibit 35: TMB has high proportion of MSME and agri loans



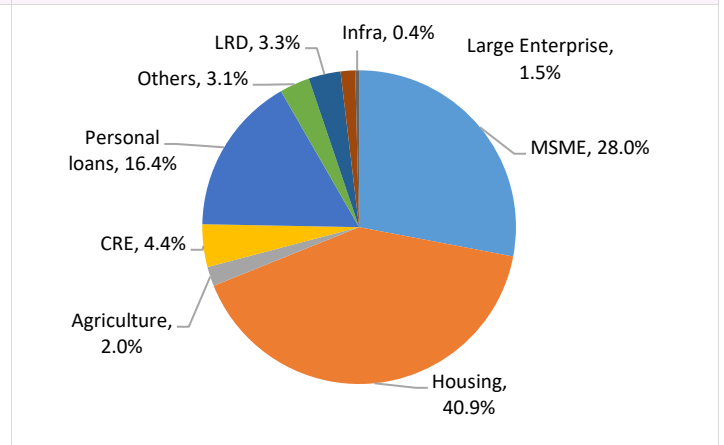
Source: Company, ACMIIL research

Exhibit 36: Gold loans having high share in Karur Vyasa Bank's advances book



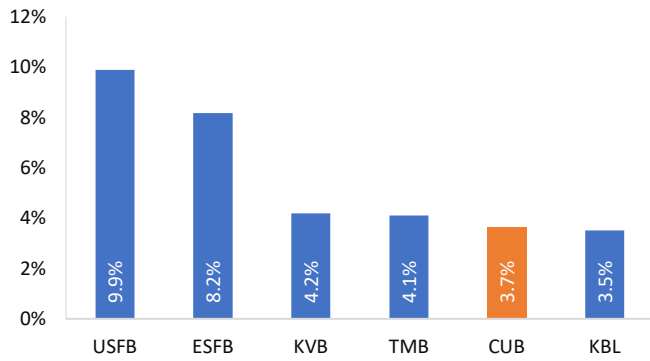
Source: Company, ACMIIL research

Exhibit 37: Karnataka Bank has high share of housing loans in its advances mix



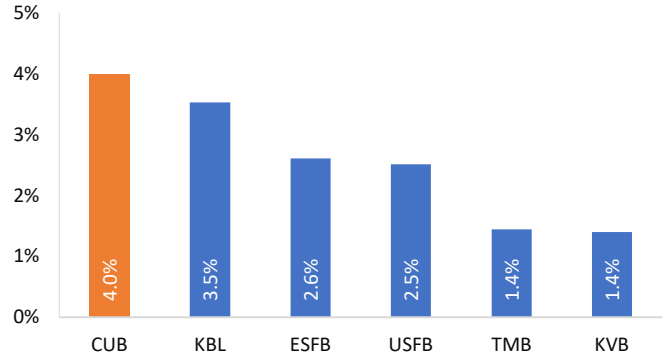
Source: Company, ACMIIL research

Exhibit 38: CUB has low NIM as compared to peers due to high proportion of secured lending



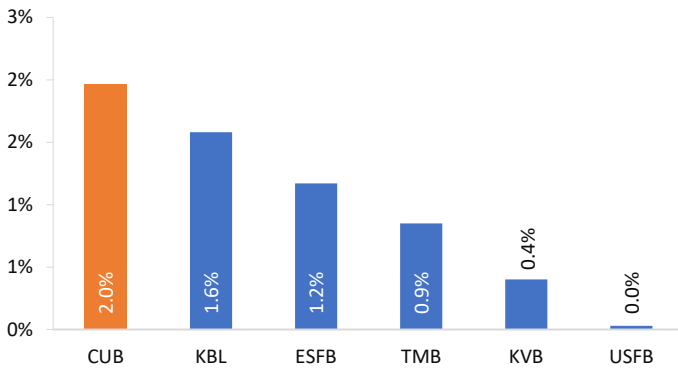
Source: Company, ACMIIL research

Exhibit 39: CUB has high level of gross NPA as compared to peers



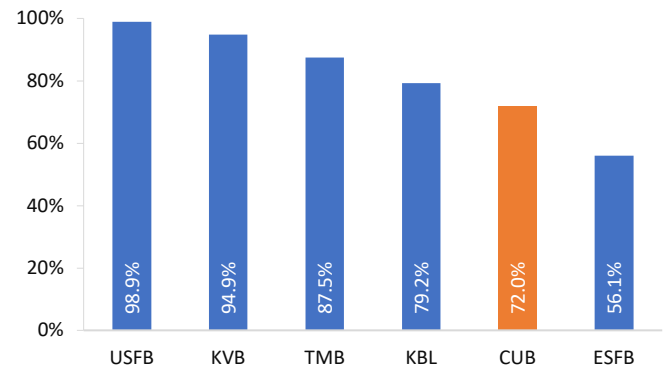
Source: Company, ACMIIL research

Exhibit 40: CUB's net NPA has improved in the last 3 FYs but remains higher than peers



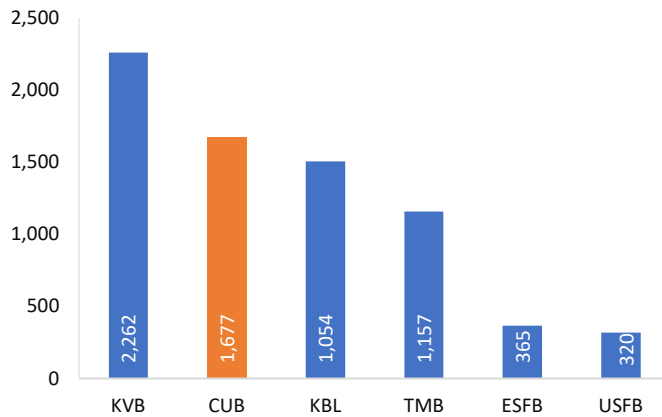
Source: Company, ACMIIL research

Exhibit 41: CUB maintains low PCR due to high share of secured lending in its assets book



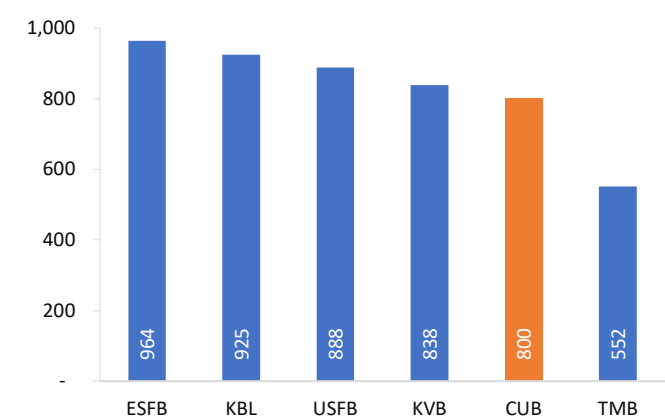
Source: Company, ACMIIL research

Exhibit 42: CUBs ATM count remains higher than peers



Source: Company, ACMIIL research

Exhibit 43: Branch count of CUB as compared to its peers



Source: Company, ACMIIL research

Corporate Governance

City Union Bank's Board of Directors has a total strength of nine members. Of these, eight are Independent Directors including a woman director, and MD and CEO. The bank has diverse professional experts on its board. The detailed designations, qualification and experience of the directors are as follows:

Board of Directors

Mr. G. Mahalingam, Non-Executive Chairman

Mr. Gurumoorthy Mahalingam had a long career in the financial sector. He worked at the Reserve Bank of India (RBI) for 34 years, retiring as an Executive Director. Mr. Mahalingam served the Securities and Exchange Board of India (SEBI) as a whole-time board member. Master's in Statistics and Operations Research from IIT Kanpur and an MBA in International Banking from the UK, he has a wealth of experience in banking regulation, supervision and market operations.

Dr N. Kamakodi, M.D. & C.E.O.

Dr. N. Kamakodi is serving as the MD & CEO of City Union Bank from May 2011. He joined the bank as the DGM in 2003 and was elevated to GM in 2005 and later to Executive Director in 2006.

Mr. Subramaniam Narayanan, Director

Mr. Subramaniam Narayanan has extensive experience in business management, private equity, finance, accountancy, treasury and risk management, information technology and payment and settlements. He has served as the CEO of First India Asset Management Company Ltd. and managed treasury services for Bank of America and Abu Dhabi Commercial Bank in the UAE. Additionally, Mr. *Narayanan* has been a long-time director in well-known IT and fintech companies.

Dr. T.S. Sridhar IAS (Retd.), Director

Dr T.S. Sridhar is a retired IAS officer with 35 years of extensive experience in various administrative roles. As the principal secretary, agriculture, Government of Tamil Nadu, he developed expertise in rural economy, the agricultural sector and industries, particularly MSMEs. He also served as a director on the board of NABARD and has substantial knowledge in human resources and economics.

Mr. T.K. Ramkumar, Director

Mr. T.K. Ramkumar is a prominent lawyer based in Chennai with specialised knowledge and expertise in banking law, company law and intellectual property rights. He is also an active environmentalist.

Mr. V.N. Shivashankar, Director

Mr. V.N. Shiva Shankar is a qualified lawyer, company secretary and cost management accountant with over 25 years of extensive experience in Indian corporate law. Mr. Shankar is the founder of M/s VNS Legal Corporate Law firm in Chennai, which specialises in legal advisory services on capital market regulation, takeover offers, corporate litigation, etc. He is also a member of the Executive Committee of the Southern India Chamber of Commerce, with expertise in SEBI matters and risk management.

Mr. K. Vaidyanathan, Director

Mr. K. Vaidyanathan is a fellow member of both, the Institute of Cost Management Accountants of India and the Institute of Company Secretaries of India. With over 40 years of experience, he specialises in financial and management accounting, corporate finance, auditing and regulatory compliance. Mr. Vaidyanathan is a practicing company secretary and has expertise in compliance and business management.

Prof. V. Kamakoti, Director

Prof. V. Kamakoti has a Bachelor of Engineering, a Master of Science and a Ph.D. in Computer Science from the Indian Institute of Technology (IIT) in Chennai (formerly, Madras). He became one of the youngest professors at IIT Madras and

is currently the director of the bank. His expertise lies in IT-related secured systems engineering and security-related software engineering.

Smt. Lalitha Rameswaran, Director

Mrs. Lalitha Rameswaran is a practicing chartered accountant and a qualified systems auditor. She has extensive experience in both, direct and indirect taxation. , Mrs. Rameswaran has represented public and private sector banks on tax-related matters before various tribunals.

Directors' shareholdings in the company:

As of 26th June 2023, Mr. V.N. Shivashankar and Dr. T.S. Sridhar held negligible shares in the company (<1%).

Details of remuneration

YE March (Rs mn)	FY19	FY20	FY21	FY22	FY23
Directors & KMPs Remuneration (Rs mn)	42	68	57	55	56
% of PBT	0.5%	1.2%	0.8%	0.6%	0.5%
Auditors' Remuneration (Rs mn)	5	7	7	8	8
% of PBT	0.1%	0.1%	0.1%	0.1%	0.1%

Source: Company, ACMIIL research

Contingent liability

YE March (Rs mn)	FY20	FY21	FY22	FY23
Claim against the Bank not acknowledged as debt:	50	81	82	56
Liability on account of outstanding Forward Exchange Contracts	64,551	63,383	74,448	83,220
Guarantees given on behalf of Constituents				
- In India	14,552	14,387	14,135	15,733
- Outside India	161	135	153	131
Acceptances, endorsements and other obligations	5,292	3,410	3,508	2,740
Other items for which the Bank is contingently liable	422	519	630	756
Total	85,027	81,915	92,957	1,02,637
% of Net worth	161%	140%	141%	138%

Source: Company, ACMIIL research

CSR Expenses

YE March (Rs mn)	FY21	FY22	FY23
Prescribed Expenditure (2% of Avg. Net Profit)	153	147	151
Total Spends	110	118	127
% of prescribed limit	71%	80%	84%
Avg. Net Profit of preceding 3 years	7,662	7,339	7,548

Source: Company, ACMIIL research

ACMIIL vs Consensus

Our estimates remains higher than the BBG consensus, especially in FY26E, as we remain positive on the retail lending prospects of the company, which will eventually improve its margin and lead to growth in its top-line.

YE March (Rs mn)	FY25E	FY26E
Net Interest Income		
Consensus	23,601	26,765
ACMIIL Est	24,921	29,199
Difference (%)	5.6%	9.1%
PAT		
Consensus	10,740	12,053
ACMIIL Est	11,444	13,394
Difference (%)	6.5%	11.1%
BVPS (GAAP) (Rs)		
Consensus	123.8	139.5
ACMIIL Est	128.9	147.0
Difference (%)	4.1%	5.4%

Source: Bloomberg, ACMIIL research

Key risks

Geographical concentration

City Union Bank has a geographical concentration in the southern region, particularly Tamil Nadu. This poses a key risk because any economic problems or disruptions in that area could significantly affect the bank.

Dependency on digital initiative

CUB is focussing more on retail lending, but this comes with risks due to high competition. The bank faces pressure from both, existing rivals and new players, such as fintech companies and NBFCs, which can reduce its market share. Additionally, it has set up a new sales vertical, increasing its focus on retail lending. This poses a dependency risk for the bank since its performance will depend on the execution of this strategy.

Lending to NBFC

NBFC lending of City Union Bank has increased significantly over the years. Increased exposure to NBFC lending increases the risk for the bank.

Low CASA

The bank has a low CASA ratio of 30% as of FY24. This poses a risk to the bank since lower CASA results in higher borrowing costs.

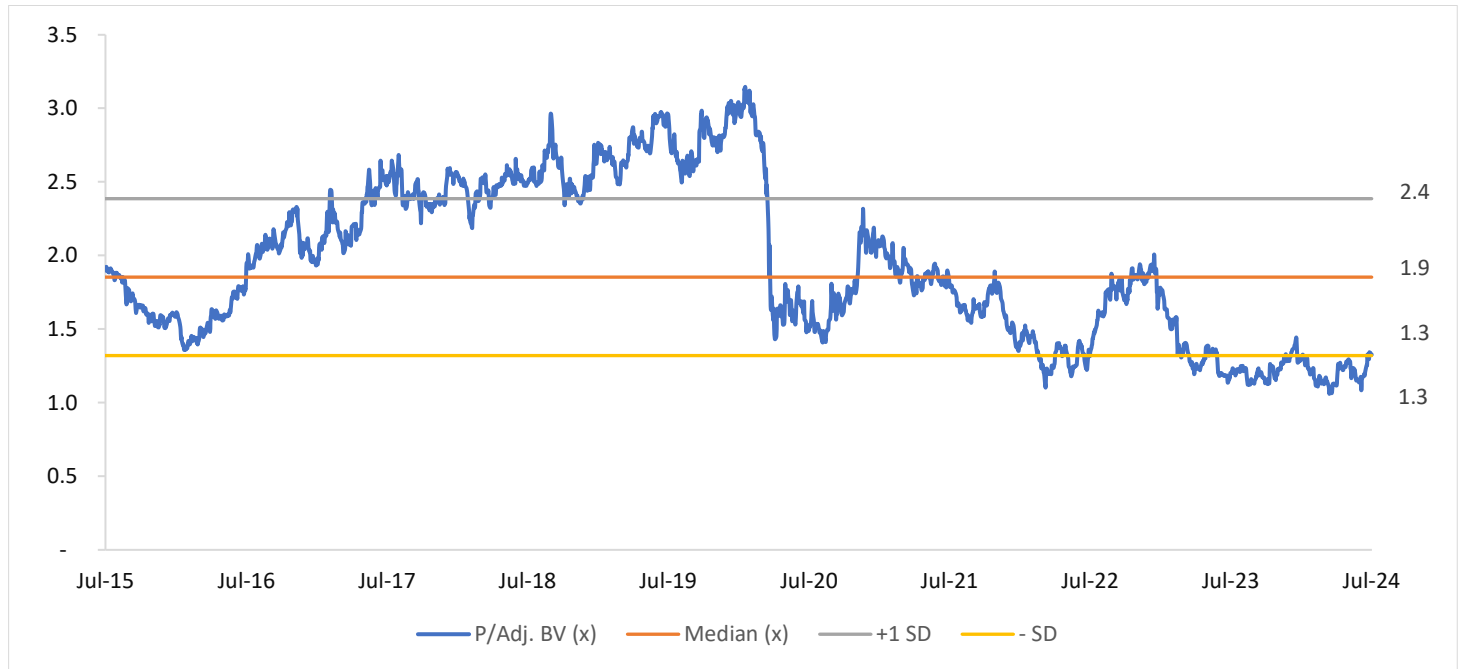
Management commentary on CUB's outlook

- The management commented on its collaboration with BCG for digitally processing loans, improving loan underwriting practices and formulating a credit hub technology.
- At present, the bank has eight credit hubs for disbursement of loans and has disbursed ~Rs 30mn.
- The software which is being used for digital lending is **Newgen**.
- The software determines the initial eligibility of the customer by verifying his/her documents, such as ITR, GST, CIBIL and generating results for approval/disapproval of a loan within an hour.
- The incremental expenditure on technological upgrade is expected to be ~Rs 280mn.
- The time taken for loan approval has been reduced from 3-7 days to 1 day while sanctioning of loan takes 3-4 days on an average.
- Historically, the loan growth has remained in single digits due to competition with other lenders.
- The management maintained its previous loan growth guidance of 12–15% in FY25 while net interest margin is expected to remain at 4%
- In order to achieve the loan growth target, the bank has formulated new lending hubs, recruited executives from competing banks having expertise in lending processes.
- Majorly, CUB's loan size is between Rs 7.5mn and Rs 10mn. Loans above Rs 30mn form 16–17% of its loan book.
- The bank is getting support from the government to boost its MSME loan book.
- The banks is seeing flat saving deposits/branch due to increased competition.
- It shall look to open new branches in urban locations in Tamil Nadu to achieve higher CASA.
- Of the 25 new CUB branches, 15 shall be located in other southern states.
- Yield on individual loans are as follows –
 - MSME – 10.38%
 - Agri – 8.93%
 - Housing – 10.47%
 - CRE – 11%
 - Personal loans – 10.53%
 - Education loans – 13%
 - Staff loan – 8.4%
 - Others – 9.79%
- The banks has no plan to raise capital in the near term.
- CUB's collaboration with NBFCs is yet to be structured. Sourcing of the loans shall be done by NBFCs while funding and undertaking shall be done by CUB.

Valuation and outlook

City Union Bank is trading at a one-year forward P/Adj.BV valuation of 1.3x. The bank has revamped its strategy to focus more on the retail lending, which would lead to higher NIMs. CUB expects its loan growth to be in double digits as compared to single-digit growth in the last two FYs. Margins are anticipated to be restored to the pre-COVID-19 level of 4% (implying an improvement of 40bps from FY24 NIMs). CUB has announced branch expansion in urban areas of southern states which shall aid in the improvement of its CASA ratio. With the loan book growth of 10%/14.7% in FY25E/FY26E and margin at 4% in FY26E, we estimate its NII/PAT to expand at a CAGR of 17.3%/14.2% over FY24–26E. We value its FY26E P/Adj. BV at 1.5x to arrive at a target price of Rs 205 (upside of 23%) and initiate coverage with a **BUY** rating.

1 year forward P/Adj. BV (x)



Source: Company, ACMIIL Research

Financials

Income Statement

YE March (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Interest earned	41,048	47,143	52,706	59,438	67,711
Interest expended	21,883	25,515	31,471	34,517	38,512
Net interest income	19,165	21,628	21,235	24,921	29,199
Non interest income	7,591	8,104	7,417	7,516	8,223
Total income	26,756	29,732	28,651	32,437	37,422
Employee cost	5,036	5,304	6,138	7,050	7,821
Other operating expenses	5,767	6,248	7,346	7,916	9,246
Operating expenses	10,803	11,552	13,484	14,966	17,067
Pre-provision operating profit	15,953	18,180	15,167	17,471	20,355
Provisions and contingencies	6,101	6,405	2,860	2,986	3,400
Profit before tax	9,852	11,775	12,307	14,486	16,955
Tax	2,250	2,400	2,150	3,042	3,561
Profit after tax	7,602	9,375	10,157	11,444	13,394
EPS (Rs)	10.3	12.7	13.7	15.5	18.1

Source: Company, ACMIIL Research

Yields (%)

YE March	FY22	FY23	FY24	FY25E	FY26E
Yield on advances	9.0	9.1	9.4	9.6	9.8
Yield on investments	5.8	6.3	6.4	6.6	6.6
Cost of deposits	4.6	4.6	5.4	5.4	5.4
Net interest margin	4.0	3.9	3.6	3.8	4.0
Loan-deposit ratio	84.6	82.2	81.8	82.4	84.2
CASA ratio	32.6	29.9	30.6	31.1	30.6

Source: Company, ACMIIL Research

Asset quality (%)

YE March	FY22	FY23	FY24	FY25E	FY26E
Gross NPA (Rs mn)	19,332	19,202	18,544	17,715	18,794
Net NPA (Rs mn)	11,911	10,176	8,987	6,292	5,964
Gross NPA	4.7	4.4	4.0	3.5	3.2
Net NPA	3.0	2.4	2.0	1.2	1.0
Credit cost	1.4	1.7	0.7	0.0	0.0
Provision coverage ratio	62.3	69.0	72.0	71.8	72.2
Slippages	3.1	3.0	2.2	2.1	2.0
Gross NPA (Rs mn)	19,332	19,202	18,544	17,715	18,794
Net NPA (Rs mn)	11,911	10,176	8,987	6,292	5,964

Source: Company, ACMIIL Research

YoY growth (%)

YE March	FY22	FY23	FY24	FY25E	FY26E
Net interest income	4.7	12.9	(1.8)	17.4	17.2
Pre-provision operating profit	7.2	14.0	(16.6)	15.2	16.5
Profit before tax	42.2	19.5	4.5	17.7	17.0
Profit after tax	28.2	23.3	8.3	12.7	17.0
Advances	11.2	6.8	5.9	9.8	14.7
Deposits	7.1	9.9	6.2	11.5	12.4
Net interest income	4.7	12.9	(1.8)	17.4	17.2
Pre-provision operating profit	7.2	14.0	(16.6)	15.2	16.5
Profit before tax	42.2	19.5	4.5	17.7	17.0

Source: Company, ACMIIL Research

Balance Sheet

YE March (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Share capital	740	740	741	748	754
Reserves and surplus	65,117	73,832	83,274	94,717	1,08,112
Net worth	65,857	74,572	84,014	95,465	1,08,866
Deposits	4,76,897	5,23,979	5,56,566	6,20,481	6,97,259
Borrowings	53,118	46,881	47,242	50,877	55,033
Other liabilities and provisions	19,437	20,514	20,436	18,489	28,488
Total equity and liabilities	6,15,309	6,65,946	7,08,259	7,85,311	8,89,646
Cash and balances with RBI	66,869	66,493	69,435	68,475	78,516
Investments	1,22,212	1,43,326	1,56,641	1,72,407	1,88,110
Advances	4,03,585	4,30,533	4,55,257	5,11,363	5,86,789
Fixed assets	2,147	2,393	2,704	2,904	3,104
Other assets	20,496	23,200	24,221	30,163	33,127
Total assets	6,15,309	6,65,946	7,08,259	7,85,311	8,89,646
BVPS (Rs)	89.0	100.7	113.4	128.9	147.0
Adj. BVPS (x)	72.9	87.0	101.3	120.4	138.9

Source: Company, ACMIIL Research

Ratios (%)

YE March	FY22	FY23	FY24	FY25E	FY26E
Tier 1	19.8	21.3	22.8	22.2	21.9
CAR	20.9	22.3	23.8	23.2	22.9
ROA	1.3	1.5	1.5	1.5	1.6
ROE	12.2	13.4	12.8	12.8	13.1
Cost-to-income	40.4	38.9	47.1	50.8	50.2

Source: Company, ACMIIL Research

Valuation (x)

YE March	FY22	FY23	FY24	FY25E	FY26E
P/E	16.2	13.2	12.2	10.8	9.2
P/BV	1.9	1.7	1.5	1.3	1.1
P/Adj. BV	2.3	1.9	1.6	1.4	1.2

Source: Company, ACMIIL Research

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	<-10%
HOLD	>-10% to 15%

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