

Seasonally weak quarter with deterioration in asset quality

CMP: INR 129

Rating: Buy

Target Price: INR 158

Stock Info

| | |
|--------------------------|-----------|
| BSE | 532648 |
| NSE | CUB |
| Bloomberg | CUBK IN |
| Reuters | CUBK.BO |
| Sector | Banks |
| Face Value (INR) | 1 |
| Equity Capital (INR Cr) | 74 |
| Mkt Cap (INR Cr) | 9,732 |
| 52w H/L (INR) | 205 / 119 |
| Avg Yearly Vol (in 000') | 3,854 |

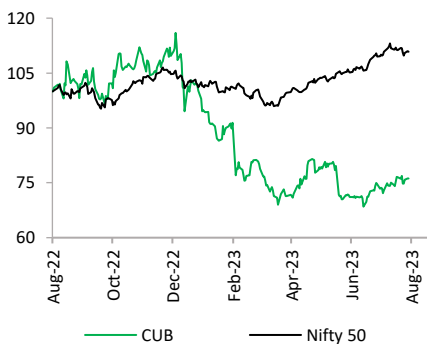
Shareholding Pattern %

(As on June, 2023)

| | |
|-----------------|-----|
| Promoters | Nil |
| Public & Others | 100 |

| Stock Performance (%) | 1m | 6m | 12m |
|-----------------------|------|-------|-------|
| CUB | 2.02 | -2.48 | -24.8 |
| Nifty 50 | 0.05 | 9.44 | 10.13 |

CUB Vs Nifty



Abhishek Jain
abhishek.jain@arihantcapital.com
Harshit Jain
harshit.jain@arihantcapital.com

City Union Bank (CUB) has displayed a seasonally weak performance during Q1FY24 with marginal increase in profit by 0.9% YoY/ 4% QoQ to INR 227 cr, was lower than our estimate of INR 238 cr, driven by increasing cost of funds. NII improved marginally by 1.6% QoQ at INR 523 cr, declined by 0.5% YoY. Bank has reported credit growth of 4% YoY. Management has given a credit growth guidance of 12 -15% for the FY24, led by digital lending. Asset quality of the bank degraded with GNPA/NNPA ratio increased by 54bps/15bps QoQ at 4.9%/2.5% respectively. Gross slippages of the bank increased by 7% QoQ at INR 382 cr.

PPOP de-growth led by increasing OPEX, cost of funds & declining other income

NII for the quarter declined marginally by -0.5% YoY/1.6% QoQ to INR 523 cr, led by credit growth of 3.6% YoY/-3.6% QoQ and increasing cost of funds at 4.57% (+84bps YoY, +23bps QoQ). NIM of the bank declined by 28bps YoY at 3.67%. Other income declined by 12%YoY/2% QoQ due to decline in recoveries from written-off accounts. There was recovery from written off a/cs to the tune of INR 62.7 cr vs. INR 112 cr YoY and INR 84 cr QoQ. Bank has reported treasury profit of INR 40 cr as compared to profit of INR 22 cr in Q4FY23. Operating expenses increased by 1.5% YoY/2.6% QoQ. Operating profit for the quarter declined by 7% YoY/1% QoQ to INR 414 cr, was lower than our estimate of INR 436.7 cr.

Loan growth guidance of 12-15%

Bank's total advances grew by 3.6% YoY/-3.6% QoQ to INR 42,405 cr. The bank has initiated a project with BCG consulting, for proper implementation of digital lending, which will help them ensure that the growth is accelerated during the FY24. The digital lending is expected to improve their TAT from 15 days to 2 days. The digital lending will start will MSME lending with amount less than INR 5 cr. Further, Bank is also in discussion for co-lending opportunities with Tamil Nadu based NBFCs. They are looking for opportunities in secured advances front like gold loan, vehicle loan or housing loan. This will help them achieve their credit growth guidance. Deposit growth improved to 5.9% YoY/-1.4% QoQ with CASA ratio at 30.8% vs. 29.9% QoQ.

Deterioration in asset quality led by increasing slippages and declining recoveries

Bank has reported gross slippages of INR 382 cr (+6.2% QoQ/+40% YoY) or 0.9% of gross advances (vs. 0.8% in Q4FY23). Recoveries & upgrades was weak at INR 121 cr for Q1FY24 (INR 290 cr in Q4FY23). Write-offs for the quarter was at INR 100 cr as compared to INR 136 cr in Q4FY23. Restructured book declined by 9% QoQ at INR 1141 cr (~2.7% of advances).

Valuation & View: The bank has shown a seasonally weak quarter with deterioration in asset quality. Their profitability is expected to decline slightly in Q2FY24, which will be compensated in the second half of the FY24. The bank has initiated a digital lending project with BCG consulting, which will help them achieve a credit growth of 12-15% during the FY24. Further, bank is also looking into co lending opportunities with Tamil Nadu based NBFC, which will help them improve the performance in the second half of the FY24. We have a long term positive outlook on the company. We upgrade our rating on the stock to BUY with a revised target price of INR 158 (earlier INR 182), valuing the bank at P/adj. BV of 1.1x FY26E ABV.

| Particulars (INR Cr) | FY22 | FY23 | FY24E | FY25E | FY26E |
|----------------------|-------|-------|-------|-------|-------|
| NII | 1,916 | 2,163 | 2,497 | 2,767 | 3,217 |
| PPOP | 1,595 | 1,818 | 2,104 | 2,464 | 2,953 |
| PAT | 760 | 937 | 1,152 | 1,456 | 1,784 |
| NIM (%) | 3.5 | 3.5 | 3.7 | 3.8 | 4.0 |
| RoA (%) | 1.3 | 1.5 | 1.6 | 1.9 | 2.1 |
| RoE (%) | 12.2 | 13.4 | 14.3 | 15.6 | 16.3 |
| P / ABV (x) | 1.8 | 1.5 | 1.3 | 1.1 | 0.9 |

Quarterly Result Snapshot

| Particulars | Q1FY24 | Q4FY23 | Q1FY23 | QoQ | YoY |
|-------------------------|------------|------------|------------|--------------|--------------|
| Interest Earned | 1266 | 1228 | 1099 | 3.1% | 15.2% |
| Interest Expended | 744 | 714 | 575 | 4.2% | 29.4% |
| NII | 523 | 514 | 525 | 1.6% | -0.5% |
| NIM (%) | 3.67 | 3.65 | 3.95 | 0.5% | -7.1% |
| Non-interest income | 191 | 195 | 218 | -1.8% | -12.0% |
| Operating Expenses | 300 | 292 | 295 | 2.6% | 1.5% |
| Employee cost | 132 | 130 | 133 | 1.9% | -0.4% |
| Cost-Income ratio (%) | 41.98 | 41.20 | 39.80 | 1.9% | 5.5% |
| Operating Profit | 414 | 417 | 447 | -0.7% | -7.4% |
| Provisions | 152 | 159 | 152 | -4.4% | 0.0% |
| PBT | 262 | 258 | 295 | 1.6% | -11.1% |
| Tax provisions | 35 | 40 | 70 | -12.5% | -50.0% |
| Effective tax rate | 13.35% | 15.50% | 23.72% | -13.9% | -43.7% |
| Net profit | 227 | 218 | 225 | 4.2% | 0.9% |
| EPS | 3.1 | 3.0 | 3.0 | 4.4% | 1.3% |

Asset Quality (%)

| Particulars | Q1FY24 | Q4FY23 | Q1FY23 | QoQ | YoY |
|-------------|--------|--------|--------|--------|--------|
| GNPA | 4.9 | 4.4 | 4.7 | 54bps | 26bps |
| NNPA | 2.5 | 2.4 | 2.9 | 15bps | -38bps |
| PCR | 70.0 | 69.0 | 64.0 | 100bps | 600bps |

Business Performance

| Particulars | Q1FY24 | Q4FY23 | Q1FY23 | QoQ | YoY |
|--------------------|--------|--------|--------|---------|---------|
| Advances | 42405 | 43971 | 40934 | -3.6% | 3.6% |
| Deposits | 51655 | 52398 | 48772 | -1.4% | 5.9% |
| CASA | 15893 | 15657 | 15387 | 1.5% | 3.3% |
| CASA % | 30.8 | 29.9 | 31.5 | 89bps | -78bps |
| C-D ratio % | 82.1 | 83.9 | 83.9 | -182bps | -184bps |
| NIM | 3.67 | 3.65 | 3.95 | 2bps | -28bps |
| Capital Adequacy % | 23.0 | 22.3 | 20.5 | 68bps | 254bps |

Q1FY24 Conference Call Highlights:

- Management has given a credit growth guidance of 12 – 15% for the FY24.
- Q1FY24 was weak in terms of growth. NIMs came at 3.67% (-28bps YoY, +2bps QoQ).
- Advances declined by 3.6% QoQ at INR 424.05 bn (+3.6% YoY).
- The Provision Coverage Ratio (including TW) as on 30.06.2023 stood at 70% and PCR without TW is at 50%.
- The cost to income ratio for the current quarter stood at 41.98% v/s 41.2% in Q4FY23 v/s 39.8% in Q1FY23.
- The company has given a guidance of 42 – 44% cost-to-income ratio for the FY24.
- The bank closed their SPICE JET account by using the extra provisions made earlier.
- The bank has initiated a project with BCG consulting, for proper implementation of digital lending, which will help them ensure that the growth is accelerated during the FY24.
- The digital lending is expected to improve their TAT from 15 days to 2 days.
- The digital lending will start with MSME lending with amount less than INR 5 cr.
- The bank has formed a committee for smooth succession of Dr. N. Kamakodi, whose tenure ends on 30th April 2026.

Key Financials

| Income Statement | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|
| Income Statement (Rs Cr) | 2022 | 2023 | 2024E | 2025E | 2026E |
| Interest Earned | 4105 | 4714 | 5543 | 6298 | 7093 |
| Interest Expended | 2188 | 2552 | 3046 | 3531 | 3876 |
| Net Interest Income | 1916 | 2163 | 2497 | 2767 | 3217 |
| Other Income | 759 | 810 | 886 | 1068 | 1208 |
| Fee Income | 292 | 336 | 370 | 410 | 459 |
| Treasury Income | 246 | 334 | 402 | 543 | 634 |
| Operating Income | 2676 | 2973 | 3383 | 3835 | 4426 |
| Other Expenses | 577 | 625 | 700 | 784 | 878 |
| Employee Expenses | 504 | 530 | 579 | 587 | 594 |
| Profit before provision & tax | 1595 | 1818 | 2104 | 2464 | 2953 |
| Provisions and Contingencies | 610 | 641 | 565 | 518 | 569 |
| Profit Before Tax | 985 | 1177 | 1540 | 1946 | 2384 |
| Provision for tax | 225 | 240 | 388 | 490 | 600 |
| Exp. Items | 0 | 0 | 0 | 0 | 0 |
| Profit After Tax | 760 | 937 | 1152 | 1456 | 1784 |

| Balance Sheet | | | | | |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|
| Balance Sheet (Rs Cr) | 2022 | 2023 | 2024E | 2025E | 2026E |
| Sources of funds | | | | | |
| Share Capital | 74 | 74 | 74 | 74 | 74 |
| Total Reserves | 6512 | 7383 | 8535 | 9992 | 11776 |
| Shareholder's Fund | 6586 | 7457 | 8609 | 10066 | 11850 |
| Deposits | 47690 | 52398 | 57527 | 63200 | 69475 |
| Borrowings | 5312 | 4688 | 4922 | 5267 | 5688 |
| Other Liabilities & provisions | 1944 | 2051 | 2231 | 2656 | 2972 |
| Total Liabilities | 61532 | 66594 | 73290 | 81187 | 89984 |
| Application of Funds | | | | | |
| Cash & Bank | 6687 | 6649 | 7010 | 7707 | 8393 |
| Investments | 12221 | 14333 | 14366 | 15788 | 17359 |
| Advances | 40358 | 43053 | 48650 | 53515 | 58867 |
| Fixed Assets | 215 | 239 | 294 | 377 | 501 |
| Other Assets | 2050 | 2320 | 2970 | 3801 | 4865 |
| Total Assets | 61531 | 66595 | 73291 | 81188 | 89985 |

| Ratios % | | | | | |
|---------------------------|-------|------|-------|-------|-------|
| Operational Ratios (%) | 2022 | 2023 | 2024E | 2025E | 2026E |
| Asset Quality | | | | | |
| Gross NPA | 4.8 | 4.4 | 4.2 | 4.2 | 4.2 |
| Net NPA | 3.0 | 2.4 | 2.2 | 2.2 | 2.1 |
| PCR | 64.0 | 64.0 | 60.0 | 60.0 | 60.0 |
| Growth | | | | | |
| Advances Growth | 11.6 | 6.7 | 13.0 | 10.0 | 10.0 |
| Deposit growth | 7.1 | 9.9 | 9.8 | 9.9 | 9.9 |
| Net Profit Growth | -97.0 | 23.3 | 22.9 | 26.4 | 22.5 |
| Liquidity | | | | | |
| C-D Ratio | 84.6 | 82.2 | 84.6 | 84.7 | 84.7 |
| CASA | 32.6 | 29.9 | 29.9 | 30.0 | 30.0 |
| Capital Adequacy | 20.9 | 22.3 | 22.1 | 23.5 | 25.2 |
| Efficiency | | | | | |
| Cost Income Ratio | 40.4 | 38.9 | 37.8 | 35.7 | 33.3 |
| Operating Costs to Assets | 1.8 | 1.7 | 1.7 | 1.7 | 1.6 |

| Ratios % | | | | | |
|--------------------------|------|------|-------|-------|-------|
| Valuation Ratios (%) | 2022 | 2023 | 2024E | 2025E | 2026E |
| Spread Analysis | | | | | |
| Yield on Advances | 9.4 | 9.2 | 9.7 | 9.8 | 10.0 |
| Yield on Investments | 5.8 | 6.3 | 7.0 | 8.0 | 8.5 |
| Cost of Funds | 4.4 | 4.6 | 5.1 | 5.4 | 5.4 |
| Cost of Deposits | 4.6 | 4.8 | 5.4 | 5.8 | 5.8 |
| NIM | 3.5 | 3.5 | 3.7 | 3.8 | 4.0 |
| Interest Spread | 4.9 | 4.6 | 4.6 | 4.4 | 4.6 |
| Profitability | | | | | |
| ROE | 12.2 | 13.4 | 14.3 | 15.6 | 16.3 |
| ROA | 1.3 | 1.5 | 1.6 | 1.9 | 2.1 |
| Earnings Per Share (Rs) | 10.3 | 12.7 | 15.6 | 19.7 | 24.1 |
| Adjusted Book Value (Rs) | 72.9 | 86.6 | 101.7 | 120.1 | 143.3 |
| Valuation | | | | | |
| P / EPS (x) | 12.5 | 10.2 | 8.3 | 6.6 | 5.4 |
| P / ABV (x) | 1.8 | 1.5 | 1.3 | 1.1 | 0.9 |

Arihant Research DeskEmail: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office

#1011, Solitaire Corporate Park
 Building No. 10, 1st Floor
 Andheri Ghatkopar Link Road
 Chakala, Andheri (E)
 Mumbai – 400093
 Tel: (91-22) 42254800
 Fax: (91-22) 42254880

Registered Office

Arihant House
 E-5 Ratlam Kothi
 Indore - 452003, (M.P.)
 Tel: (91-731) 3016100
 Fax: (91-731) 3016199

Stock Rating Scale

| Stock Rating Scale | Absolute Return |
|--------------------|-----------------|
| BUY | >20% |
| ACCUMULATE | 12% to 20% |
| HOLD | 5% to 12% |
| NEUTRAL | -5% to 5% |
| REDUCE | -5% to -12% |
| SELL | <-12% |

**Research Analyst
Registration No.**

INH000002764

Contact

SMS: 'Arihant' to 56677

Websitewww.arihantcapital.com**Email Id**instresearch@arihantcapital.com

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Arihant Capital Markets Ltd.
 1011, Solitaire Corporate park, Building No. 10, 1st Floor,
 Andheri Ghatkopar Link Road, Chakala, Andheri (E)
 Tel. 022-42254800 Fax. 022-42254880