

CMP: INR 133

Rating: BUY

Target Price: INR 172

Stock Info

BSE	532648
NSE	CUB
Bloomberg	CUBK IN
Reuters	CUBK.BO
Sector	Banks
Face Value (INR)	1
Equity Capital (INR Mn)	740
Mkt Cap (INR Mn)	98,770
52w H/L (INR)	205 / 119
Avg Yearly Vol (in 000')	4,144

Shareholding Pattern %

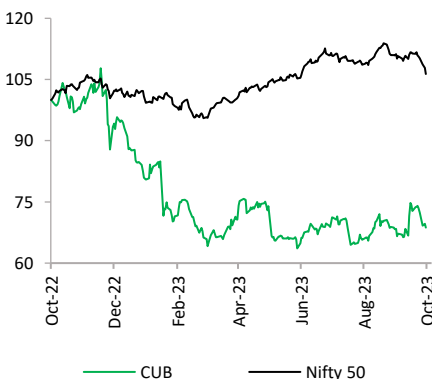
(As on September, 2023)

Promoters	Nil
Public & Others	100

Stock Performance (%)

	1m	6m	12m
CUB	4.07	-3.97	-28.8
Nifty 50	-3.7	6.24	7.3

CUB Vs Nifty



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City Union Bank (CUB) has displayed a seasonally weak performance during Q2FY24 with sequential growth in profit by 0.3% YoY/23.5% QoQ to INR 2.81 bn, better than our estimates of INR 2.36 bn, driven by increase in NIMs. NII growth was at 3% QoQ at INR 5.38 bn, down by 5.2% YoY. Bank has reported credit growth of 3% YoY by INR 12.8 bn. Management has given a credit growth guidance of 12-15% for the FY24, to be led by digital lending. Asset quality of the bank improved with GNPA/NNPA ratio were down 25bps/17bps QoQ to 4.66%/2.34% respectively. Gross slippages of the bank decreased to INR 2.25 bn from INR 3.82 bn in Q1FY24.

PPOP de-growth led by increase in employee expenses and Cost of Deposits

NII for the quarter declined marginally by 5.2% YoY/ up 3% QoQ to INR 5.38 bn, led by interest rate pas on that happened during the middle of Q1FY24. NIM of the bank increased sequentially by 7bps QoQ/down 35bps YoY to 3.74%. Other income declined sequentially by 4.9% QoQ/ up 5% YoY due to slow credit growth over previous quarter. There was recovery from written off a/cs to the tune of INR 2.99 bn vs INR 1.21 bn in the previous quarter. Bank has reported treasury profit of INR 268 mn vs INR 400 mn in Q1FY24. Operating expenses increased by 17.2% YoY/11.4% QoQ which was due to the salary increments taken in the month of July. Hence, increased Costs and expenses led to Operating profit decline by 15.3% YoY/6.7% QoQ to INR 3.87 bn, was lower than our estimate of INR 4.3 bn.

Loan growth guidance of 12-15%

Bank's total advances growth was flat (down -0.1% YoY/up 0.6% QoQ) to INR 426.5 bn. The bank has initiated a project with BCG consulting for proper implementation of digital lending platform being developed by Newgen Software going as per scheduled timeline. This will ensure that the growth is accelerated in H2FY24 when the bank sees maximum credit demand in their business. The digital lending will start with MSME lending of amount less than INR 30 mn from end of November, and by the end of Jan 2024, will cover all branches with more than half lending products. Deposits grew by 5.7% YoY/2.1% QoQ with CASA ratio going down further by 172bps YoY/119bps QoQ at 29.58% from 30.77% in Q1FY24.

Reduction in overall NPAs expected in subsequent quarters

Bank has reported gross slippages of INR 2.25 bn from INR 3.82 bn in previous quarter with slippage ration coming down to 2.06% from 2.45% in Q1FY24. The GNPA/NNPA came down by 25bps/17bps to 4.66%/2.34% respectively.

Recoveries higher than slippages taking net slippages in negative territory

With the bank's recoveries at INR 2.99 bn higher than the slippages of INR 2.25 bn, net slippages came in negative territory, hence Credit Cost of 0.45% in Q1FY24 came down to zero for the quarter along side PCR at 71%. This surprising scenario can continue in subsequent quarters if slippage ratio comes below 2%.

Valuation & View: The bank has posted decent enough margins sequentially compared to its industry peers. Their profitability is expected to increase as the recoveries continue to be higher than the Provisioning required for each quarter. With the digital lending platform coming right during their seasonal strong quarter, i.e. Q4, we believe the bank can post the annual growth guidance of 12-15% growth. Hence, we maintain our long term positive outlook on the company. We maintain our BUY rating on the stock with a revised target price of INR 172 (earlier INR 158), valuing the bank at P/adj. BV of 1.2x FY26E ABV.

Particulars (INR Mn)	FY22	FY23	FY24E	FY25E	FY26E
NII	19,165	21,628	24,971	27,669	32,172
PPOP	15,954	18,180	21,045	24,644	29,534
PAT	7,603	9,375	11,523	14,562	17,841
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 (INR Cr)	Q2FY24	Q1FY24	Q2FY23	QoQ	YoY
Interest Earned	1304	1266	1181	3.0%	10.4%
Interest Expended	766	744	613	3.0%	24.8%
NII	538	523	568	3.0%	-5.2%
NIM (%)	3.74	3.67	4.02	1.9%	-7.0%
Non-interest income	182	191	173	-4.9%	5.0%
Operating Expenses	334	300	285	11.4%	17.2%
Employee cost	158	132	141	19.7%	12.1%
Cost-Income ratio (%)	46.3	41.98	38.4	436bps	791bps
Operating Profit	387	414	456	-6.7%	-15.3%
Provisions	56	152	105	-63.2%	-46.7%
PBT	331	262	351	26.1%	-5.9%
Tax provisions	50	35	75	42.9%	-33.3%
Effective tax rate	15%	13.35%	21.34%	2bps	-6bps
Net profit	281	227	276	23.5%	1.5%
EPS	3.8	3.1	3.7	21.8%	0.3%

Asset Quality (%)

Particulars	Q2FY24	Q1FY24	Q2FY23	QoQ	YoY
GNPA	4.66%	4.91%	4.36%	-25bps	30bps
NNPA	2.34%	2.51%	2.69%	-17bps	-35bps
PCR	71.00%	70.00%	66.00%	100bps	400bps

Business Performance

Particulars	Q2FY24	Q1FY24	Q2FY23	QoQ	YoY
Advances	42,652	42,405	42,702	0.6%	-0.1%
Deposits	52,714	51,655	49,878	2.1%	5.7%
CASA	15,590	15,893	15,609	-1.9%	-0.1%
CASA %	29.58%	30.77%	31.30%	-119bps	-172bps
C-D ratio %	80.91%	82.09%	85.61%	-118bps	-470bps
NIM	3.74%	3.67%	4.09%	7bps	-35bps
Capital Adequacy %	22.21%	23.02%	20.08%	-81bps	213bps

Source: Arianth Research, Company Filings

Q2FY24 Conference Call Highlights:**Management Guidance:**

- Management aiming for 12-15% growth for the financial year FY24.
- Achieve an RoA of 1.3% for FY24.
- The Cost to Income ratio to be in the range of 42-45%.
- The Management intends to see the Net NPA at 1-1.5% which was their Pre-covid comfort level, and it wants to bring it down from current levels to the Pre covid levels of 1-1.5% in the next few quarters.

Key Highlights:

- Credit growth in Q2FY24 of INR 12.8 bn in the Q2.
- Slippage ratio for the bank has come down to 2.06%, which is almost equal to the Pre-covid levels. Absolute slippage stood at INR 2.25 bn for Q2FY24.
- Total recoveries made in the quarter stood at INR 2.99 bn.
- Overall, SMA numbers stood at 2.05% of the total advances, declining from 2.45% in the Q1FY24.
- Management expects the digital infrastructure and platform to launch in the H2FY24, for which the soft landing has already started, and it will help them achieve credit growth in the H2FY24.
- Management is satisfied with the bank's performance in terms of RoA at 1.69% and NIM at 3.74% for the quarter.
- For every INR 100 of slippage, the Management says they recover about INR 65-70. Hence, for the remaining INR 30-35, they need not do any Provisioning as they have the collateral and its liquid value. Hence, the Management does not feel the PCR ratio at 71% cannot be increased much beyond that, and has been so for the bank for several quarters.
- Since the recoveries are more than the slippages, hence, the Incremental net NPA automatically comes down.
- The Management noted that the MSMEs are seeing good cash flows in current times.
- However, on the growth front, the Management notes that the MSMEs are not going for capacity expansion as they used to in earlier Pre-covid cycles, and instead they are witnessing MSMEs going for ESG, renewable sources of energy like solar captive power, etc.
- The Board of Directors have already set up a committee to look for a suitable candidate for the MD position. Hence, the MD & CEO position may be filled in the next 4-5 months depending upon the RBI approval and regulations.
- The bank provides employee increments as of July month, hence there was a spike sequentially in employee expenses. However, on a H1 basis, the increase is just 6% as per the Management.
- The digital software is being made by Newgen Software and the consulting part is being seen over by BCG. By the end of November 2023, the software platform will be available with all the branches for MSME lending below INR 30 mn.
- The Management is expecting by the Q3FY24 earnings time, they will be seeing the digital platform up and running for all lending activities.
- The Management explained that most of their larger peers had double-digit Gross NPAs, and their Profitability was impacted more, hence they started their book cleaning process much earlier by 1-2 years in the Pre-covid era itself. However, going ahead, with Net slippages in negative, the Management expects the Net NPA to come down and Gross NPAs remain well below the 5% levels.
- The Management doesn't expect any further rate hike by the RBI going ahead, hence no more room for yield increase from hereon.
- On the growth front, with the digital lending platform, the bank will be able to see double digit growth in the H2FY24 as it has been the cycle of growth for the bank historically

Key Financials

Income Statement (INR Mn)	2022	2023	2024E	2025E	2026E
Interest Earned	41,048	47,143	55,435	62,979	70,934
Interest Expended	21,883	25,515	30,464	35,310	38,761
Net Interest Income	19,165	21,628	24,971	27,669	32,172
Other Income	7,592	8,104	8,863	10,679	12,083
Fee Income	2,921	3,359	3,695	4,102	4,594
Treasury Income	2,461	3,341	4,018	5,428	6,339
Operating Income	26,757	29,732	33,834	38,349	44,255
Other Expenses	5,767	6,248	6,998	7,838	8,778
Employee Expenses	5,036	5,304	5,791	5,867	5,943
Profit before provision & tax	15,954	18,180	21,045	24,644	29,534
Provisions and Contingencies	6,101	6,405	5,646	5,184	5,692
Profit Before Tax	9,853	11,775	15,398	19,460	23,842
Provision for tax	2,250	2,400	3,876	4,898	6,001
Exp. Items	0	2	0	0	0
Profit After Tax	7,603	9,375	11,523	14,562	17,841

Balance Sheet (INR Mn)	2022	2023	2024E	2025E	2026E
Sources of funds					
Share Capital	740	740	740	740	740
Total Reserves	65,117	73,832	85,354	99,916	1,17,757
Shareholder's Fund	65,857	74,572	86,095	1,00,657	1,18,498
Deposits	4,76,897	5,23,979	5,75,274	6,31,996	6,94,753
Borrowings	53,118	46,881	49,225	52,671	56,884
Other Liabilities & provisions	19,437	20,514	22,314	26,560	29,716
Total Liabilities	6,15,309	6,65,946	7,32,908	8,11,883	8,99,851
Application of Funds					
Cash & Bank	66,869	66,493	70,103	77,068	83,925
Investments	1,22,212	1,43,326	1,43,662	1,57,883	1,73,592
Advances	4,03,585	4,30,533	4,86,503	5,35,153	5,88,668
Fixed Assets	2,147	2,393	2,944	3,768	5,011
Other Assets	20,496	23,200	29,696	38,011	48,654
Total Assets	6,15,309	6,65,946	7,32,908	8,11,883	8,99,851

Source: Arian Research, Company Filings

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

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

Source: Arianth Research, Company Filings

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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%

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