

CMP: INR 144

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 |

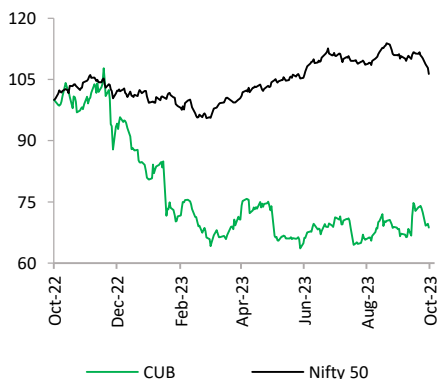
Shareholding Pattern %

(As on December, 2023)

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

| Stock Performance (%) | 1m | 6m | 12m |
|-----------------------|------|------|------|
| CUB | -0.9 | 12.8 | 0.33 |
| Nifty 50 | 4.2 | 14.1 | 24.0 |

CUB Vs Nifty



Abhishek Jain
abhishek.jain@arihantcapital.com
Anmol Das
anmol.das@arihantcapital.com
Harshit Jain
harshit.jain@arihantcapital.com

City Union Bank (CUB) has displayed a seasonally weak performance during Q3FY24 with sequential fall in profit by 9.8% QoQ/ up 16.2% QoQ to INR 2.53 bn, better than our estimates of INR 2.36 bn. NII de-grew by 4.2% QoQ/7.2% YoY to INR 5.16 bn. Bank has reported credit growth of 3.2% QoQ/2.3% YoY to INR 440 bn. Management has given a guidance of lower double digit for the FY24, to be led by digital lending. Asset quality of the bank improved with GNPA/NNPA ratio were down 19 bps/15 bps QoQ to 4.47%/2.19% respectively. In Q3FY24, the bank witnessed higher recoveries than slippages leading to negative Credit Cost.

PPOP de-growth led by increase in expenses as well as fall in NII

NII for the quarter declined marginally by 7.2% YoY/ down 4.2% QoQ to INR 5.16 bn, led by increase in Cost of Funds by 77 bps YoY /16 bps QoQ. NIM of the bank decreased sequentially by 38 bps QoQ/down 24 bps YoY to 3.50%. Other income declined by 14% YoY/ up 5.9% QoQ due to slow credit growth over previous quarter. The bank written off a/c's to the tune of INR 792 mn as a result of which the SR's stood at only 12 mn as of Dec 2023. Bank has reported treasury income of INR 242 mn vs INR 353 mn in Q3FY23. Operating expenses increased by 21.9% YoY/3.3% QoQ. Hence, increased Costs and expenses led to Operating profit decline by 26.8% YoY/5.8% QoQ to INR 3.64 bn, was lower than our estimate of INR 4.3 bn.

Loan growth guidance of early double digits for FY24

Bank's total advances growth was relatively flat (up 2.3% YoY/up 3.2% QoQ) to INR 440 bn. Deposits grew by 5.5% YoY/flat QoQ with CASA ratio came down further by 8 bps YoY/45 bps QoQ at 29.13% from 29.58% in Q2FY24.

Reduction in overall NPAs expected in subsequent quarters

Bank has reported negative Credit Cost for Q3FY24 due to higher number of recoveries than slippages in the quarter. The GNPA/NNPA came down by 19 bps/15 bps QoQ to 4.47%/2.19% respectively.

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.

Financial Snapshot:

| 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 Update (INR Mn) | Q3FY24 | Q2FY24 | Q3FY23 | Q-o-Q | Y-o-Y |
|----------------------------------|--------------|--------------|--------------|--------------|---------------|
| Interest Income | 13,262 | 13,040 | 12,056 | 1.7% | 10.0% |
| Interest Expended | 8,103 | 7,656 | 6,499 | 5.8% | 24.7% |
| Net Interest Income | 5,159 | 5,384 | 5,557 | -4.2% | -7.2% |
| Other Income | 1,929 | 1,821 | 2,243 | 5.9% | -14.0% |
| Operating Income | 7,088 | 7,205 | 7,801 | -1.6% | -9.1% |
| Operating Expenses | 3,448 | 3,339 | 2,827 | 3.3% | 21.9% |
| Employee Expenses | 1,556 | 1,582 | 1,268 | -1.6% | 22.7% |
| Other Operating Expenses | 1,891 | 1,757 | 1,559 | 7.7% | 21.3% |
| PPOP | 3,640 | 3,866 | 4,973 | -5.8% | -26.8% |
| Provisions | 460 | 560 | 2,245 | -17.9% | -79.5% |
| PBT | 3,180 | 3,306 | 2,728 | -3.8% | 16.6% |
| Tax Expenses | 650 | 500 | 550 | 30.0% | 18.2% |
| Net Income | 2,530 | 2,806 | 2,178 | -9.8% | 16.2% |
| Balance Sheet Analysis | | | | | |
| Advances | 4,40,173 | 4,26,522 | 4,30,087 | 3.2% | 2.3% |
| Deposits | 5,27,264 | 5,27,140 | 4,99,974 | 0.0% | 5.5% |
| CASA Deposits | 1,53,589 | 1,55,903 | 1,46,055 | -1.5% | 5.2% |
| CASA (%) | 29.13% | 29.58% | 29.21% | -45bps | -8bps |
| CAR (%) | 21.87% | 22.21% | 20.47% | -34bps | 140bps |
| Spreads | | | | | |
| NIMs (%) | 3.50% | 3.74% | 3.88% | -24bps | -38bps |
| Cost of Funds | 4.76% | 4.60% | 3.99% | 16bps | 77bps |
| Yield on Average Advances | 9.62% | 9.16% | 9.77% | 46bps | -15bps |
| Asset Quality | | | | | |
| GNPA | 19,681 | 20,346 | 19,887 | -3.3% | -1.0% |
| NNPA | 9,409 | 9,987 | 11,245 | -5.8% | -16.3% |
| GNPA (%) | 4.47% | 4.66% | 4.62% | -19bps | -15bps |
| NNPA (%) | 2.19% | 2.34% | 2.67% | -15bps | -48bps |
| Provision Coverage Ratio | 71% | 71% | 67% | 0bps | 400bps |
| Returns & Expenses | | | | | |
| RoA | 1.49% | 1.69% | 1.34% | -20bps | 15bps |
| RoE | 12.57% | 14.36% | 0.12% | -179bps | 1245bps |
| Cost / Income Ratio | 48.64% | 46.34% | 36.24% | 230bps | 1240bps |

Source: Arianth Research, Company Filings

Q3FY24 Conference Call Highlights:**Management Guidance:**

- The Management expects the trend of recoveries surpassing slippages to continue in the coming quarters as well.
- Cost to income ratio is elevated due to cost of automation and it will come down to 40-45% range post completion of the same.
- The bank is working towards bringing its ROE levels back to 15-16% in the next 4-8 quarters.
- NIMs would be around current levels (current levels likely to be excluding FITL impact) plus or minus 10 bps.
- In the last 2 months, the MoM average advances growth is around 1% and the bank would work towards further increasing the same.
- The bank would try and achieve close to double digit growth for FY24.

Key Highlights:

- The Gross Advances for the bank stood at INR 440 bn, up 0.8% QoQ/2.3% YoY.
- The MSME advances have de-grown by -2.0% QoQ / -4.3% YoY. The MSME segment is improving now, and the bank is getting proposals for capacity expansion.
- The Agri loans have de-grown by -5.8% QoQ / -17.1% YoY. The unwinding of the Agri KCC loan book is almost done now.
- The bank has started digital lending for loans below INR 30mn for most products. The testing for loans between Rs 30mn to INR 50mn is currently on and should be done in a months' time. The bank will then do testing for loans between INR 50 mn to INR 75 mn and that should get completed by June 2024. The loan approval turnaround time has been brought down to 48 hours, which use to take weeks earlier.
- The deposits for the bank stood at INR 527 bn, flat QoQ but up by 5.5% YoY. Around 87-88% of the deposits are either from CASA or from pure retail deposits.
- The slippages for the quarter amounted to INR 1.87 bn, translating to a gross slippage ratio of 1.7%. There was no significant impact on asset quality due to the recent floods in Tamil Nadu.
- The Total Recoveries were at INR 2.89 bn. Recoveries from live accounts amounted to INR 2.24 bn and those from technically written off accounts amounted to INR 0.65 bn. Thus, live account recoveries have surpassed slippages.
- The SMA2 amounts to 2.38% of advances and SMA1 amounts to 1.98% of advances.
- The standard restructured advances were at INR 10.29 bn or 2.34% of gross advances. The banks hold around 10% provision coverage on the restructured advances.
- Provisions were INR 0.46 bn, down by -18% QoQ / -80% YoY, translating to calculated annualized credit cost of 43 bps.
- NIM was 3.5% for Q3FY24, down -24 bps QoQ / -38 bps YoY and was 3.63% for 9MFY24. During this quarter, there was one-off interest reversal of INR 250 mn pertaining to nonperforming FITL accounts. Excluding this one-off impact, the NIM would have been 3.67% in 3QFY24 and 3.69% for 9MFY24.
- The Yield on Advances was at 9.62%, down by -15 bps QoQ. Excluding the one-off impact of interest reversal, the Yield on advances would have been 9.83% for Q3FY24. The Cost of Deposits has risen 16 bps QoQ to 5.67%.
- Total Opex, at INR 3.45 bn, is up 3.3% QoQ / 21.9% YoY. Consequently, cost/income ratio came in at 48.6%, up by 230bps QoQ / 1,240 bps YoY.
- The Employee expenses is down by -1.6% QoQ / up 22.7% YoY. Non-staff opex is up by 7.7% QoQ / 21.3% YoY.
- The RoA of the bank was at 1.49%, down by -20 bps QoQ. The RoE of the bank was at 12.6%, down by -179 bps QoQ.

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: Arian Research, Company Filings

Arihant Research DeskEmail: instresearch@arihantcapital.com

Tel. : 022-42254800

| Head Office | Registered Office |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|
| #1011, Solitaire Corporate Park Building No. 10, 1 st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880 | Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199 |

| 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. | Contact | Website | Email Id |
|--------------------------------------|--------------------------------|--------------------------------------------------------------------|--------------------------------------------------------------------------------------|
| INH000002764 | SMS: 'Arihant' to 56677 | www.arihantcapital.com | 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