

October 27, 2023

RESULT REPORT Q2 FY24 | Sector: Banks

City Union Bank

CUB ripe for a mini-bounceback but not compelling enough for an upgrade

Result Highlights (See “Our View” below for elaboration and insight)

- **Asset quality:** Gross NPA additions amounted to Rs 2.25bn for the quarter, translating to an annualized slippage ratio of 2.0%.
- **Margin picture:** NIM at 3.74% was up/down 7bps/-35bps QoQ/YoY, higher QoQ due to rise in yield on advances outpacing the rise in cost of deposits
- **Asset growth:** Advances grew 3.0%/2.3% QoQ/YoY, driven higher sequentially largely by Retail Traders, JL non-agri, Personal Loans and NBFC loans
- **Opex control:** Total opex rose 11.4%/17.2% QoQ/YoY, employee expense rose 19.7%/12.1% QoQ/YoY and other expenses rose 4.8%/22.2% QoQ/YoY
- **Fee income:** CEB and charges fell/rose -1.9%/8.4% QoQ/YoY

Our view – CUB remains close to the bottom of our pecking order

Communication of a bottoming out of asset quality issues has the potential of actuating a mini-bounceback for CUB stock: Recoveries from live accounts amounted to Rs 2.3bn and those from technically written off accounts amounted to Rs 0.61bn. Thus, live account recoveries have surpassed slippages. Management states that there will be a substantial reduction in slippages and credit cost going forward. The ROA guidance for the year is 1.5% driven by NPA recoveries.

A rundown of significant excess liquidity has the potential to cushion the impact from a further inching up of cost of deposits: The cost of deposits has risen 15 bps QoQ to 5.51% whereas, the yield on advances has risen more at 22 bps to 9.77%. The yield on advances rose materially since the full impact of passing on rates was felt during the quarter. The bank does not expect any rate hikes going forward. The CD ratio is 4-5% points lower than pre-Covid levels and the LCR for the bank is about 200%. In terms of guidance, NIM would be similar to current levels, plus or minus 10 bps.

Management continues to guide for 12-15% growth for FY24 on the back of digital lending push: The soft launch for digital lending for MSME loans below Rs 30mn has started. The project is being executed by Newgen Software and is being overseen by BCG. We had stated, in our [1QFY24 result report](#), that the digital lending strategy reveals an inability for CUB to grow via underlying, organic means.

We maintain ‘Add’ rating on CUB with a revised price target of Rs 155: We value the bank at 1.2x FY25 P/BV for an FY24E/25E/26E RoE profile of 13.1/13.4/13.5%. CUB has always been in the bottom 2 of our pecking order since our [sector initiation report dated June 2021](#).

(See Comprehensive con call takeaways on page 2 for significant incremental colour.)

Exhibit 1: Result table

(Rs mn)	Q2 FY24	Q1 FY24	% qoq	Q2 FY23	% yoy
Total Interest Income	13,040	12,662	3.0	11,812	10.4
Interest Expense	(7,656)	(7,436)	3.0	(6,133)	24.8
Net Interest Income	5,384	5,225	3.0	5,679	(5.2)
Other income	1,821	1,915	(4.9)	1,735	5.0
Total Income	7,205	7,140	0.9	7,414	(2.8)
Operating expenses	(3,339)	(2,998)	11.4	(2,849)	17.2
PPOP	3,866	4,143	(6.7)	4,565	(15.3)
Provisions	(560)	(1,520)	(63.2)	(1,050)	(46.7)
PBT	3,306	2,623	26.1	3,515	(5.9)
Tax	(500)	(350)	42.9	(750)	(33.3)
PAT	2,806	2,273	23.5	2,765	1.5

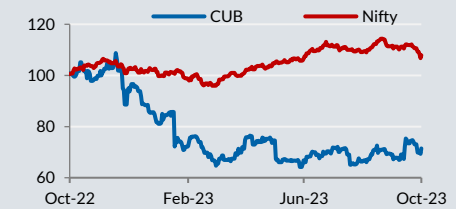
Source: Company, YES Sec-Research

Recommendation	: ADD
Current Price	: Rs 133
Target Price	: Rs 155
Potential Return	: 16%

Stock data (as on October 27, 2023)

Nifty	19,047
52 Week h/l (Rs)	205 / 120
Market cap (Rs/USD mn)	95810 / 1151
Outstanding Shares (mn)	740
6m Avg t/o (Rs mn):	579
Div yield (%):	0.8
Bloomberg code:	CUBK IN
NSE code:	CUB

Stock performance



	1M	3M	1Y
Absolute return	3.5%	-0.6%	-29.2%

Shareholding pattern (As of Sept'23 end)

Promoter	0.0%
FII+DII	56.9%
Others	43.1%

Δ in stance

(1-Yr)	New	Old
Rating	ADD	ADD
Target Price	155	145

Financial Summary

(Rs mn)	FY24E	FY25E	FY26E
NII	22,719	25,925	29,547
PPOP	18,747	21,888	25,122
Net Profit	10,395	12,017	13,784
Growth (%)	10.9	15.6	14.7
EPS (Rs)	14.0	16.2	18.6
BVPS (Rs)	113	129	146
P/E (x)	9.5	8.2	7.2
P/BV (x)	1.2	1.0	0.9
ROE (%)	13.1	13.4	13.5
ROA (%)	1.5	1.5	1.5
Tier-1 (%)	21.3	20.7	20.2

Δ in earnings estimates

Rs.	FY24E	FY25E	FY26E
EPS (New)	14.0	16.2	18.6
EPS (Old)	13.8	16.2	18.6
% change	1.8%	0.0%	0.0%

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COMPREHENSIVE CON-CALL TAKEAWAYS

Comprehensive guidance

- **Loan growth**
 - The loan growth guidance for FY24 remains 12-15%, with growth skewed towards the second half.
- **Return on assets**
 - The ROA guidance for the year is 1.5% driven by NPA recoveries.
- **Cost to income ratio**
 - The cost to income ratio would be in the range 42-45%.
- **Net interest margin**
 - NIM would be similar to current levels, plus or minus 10 bps.

Loan growth

- **Digital lending**
 - The soft launch for digital lending for MSME loans below Rs 30mn has started.
 - The project is being executed by Newgen Software and overseen by BCG.
- **Other comments**
 - The bank had to stop the agri KCC loan due to a diktat, which slowed down lending.
 - However, other segments have picked up the slack.

Asset quality

- **Slippages**
 - The slippages for the quarter amounted to Rs 2.25bn, translating to a gross slippage ratio of 2.06%.
- **Recoveries**
 - The total recoveries amounted to Rs 2.99bn.
 - Recoveries from live accounts amounted to Rs 2.3bn and those from technically written off accounts amounted to Rs 0.61bn.
 - Thus, live account recoveries have surpassed slippages.
 - The recoveries have emerged all-round with the largest account being Rs 0.19bn.
- **SMA2**
 - The SMA2 amounts to 2.05% of advances compared with 2.45% as of 1Q.
- **RBI inspection**
 - RBI inspection (Asset Quality Review) for the period ending March 2023 has been concluded.
 - No Divergence disclosure is required based on this review unlike last time when there were issues.
- **Guidance**
 - There will be a substantial reduction in slippages and credit cost going forward.

(Con call takeaways continue on the next page)

- **Provision coverage**
 - Since average recovery rate for the bank is 65-70%, a provision cover of more than 35-40% is really not required.
 - Hence, the bank does not expect any major improvement in provision coverage ratio due to the above consideration.
 - The bank, however, does intend to move back to a Net NPA ratio of FY19 and then 1-1.5% as we move forward and that would have a natural impact on coverage.
- **Credit cost guidance**
 - The credit cost can be deduced from the Net NPA ratio target.

Net interest margin

- **NIM for the quarter**
 - NIM was 3.74%, up by 7 bps QoQ.
- **Cost of deposits**
 - The cost of deposits has risen 15 bps QoQ to 5.51%
- **Yield on advances**
 - The yield on advances has risen more at 22 bps to 9.77%.
 - The yield on advances rose materially since the full impact of passing on rates was felt during the quarter.
 - The bank does not expect any rate hikes going forward.
- **Liquidity**
 - **Credit deposit ratio**
 - The CD ratio is 4-5% points lower than pre-Covid levels.
 - **LCR**
 - The LCR for the bank is about 200%.
- **Unrecognised interest**
 - The unrecognized interest due to a diktat amounts to Rs 0.2bn.

CEO succession

- The Board has appointed a sub-committee to look for candidates.

Operating expenses

- **Employee cost**
 - The sequential rise of 20% in employee cost was due to the implementation of annual increment.
 - The 1H vs 1H rise was 6%.

Exhibit 2: Key quarterly balance sheet / business data

(Rs mn)	Q2FY24	Q1FY24	% qoq	Q2FY23	% yoy	Q2FY24*	% qoq*	% yoy*
Gross Advances	436,881	424,048	3.0	427,016	2.3	100.0	0bps	0bps
Agri	74,170	78,750	(5.8)	80,673	(8.1)	17.0	-159bps	-192bps
MSME	183,036	179,727	1.8	185,427	(1.3)	41.9	-49bps	-153bps
Large Industries	6,857	6,692	2.5	6,945	(1.3)	1.6	-1bps	-6bps
Retail Traders	8,860	7,854	12.8	9,063	(2.2)	2.0	18bps	-9bps
Wholesale Traders	15,654	15,236	2.7	19,017	(17.7)	3.6	-1bps	-87bps
Comm Real Estate	24,917	30,061	(17.1)	29,748	(16.2)	5.7	-139bps	-126bps
JL Non Agri	47,438	42,719	11.0	37,960	25.0	10.9	78bps	197bps
Housing	20,232	20,452	(1.1)	20,483	(1.2)	4.6	-19bps	-17bps
Personal Loans	10,105	9,643	4.8	9,217	9.6	2.3	4bps	15bps
LCDs	7,138	6,547	9.0	6,379	11.9	1.6	9bps	14bps
Infra	2,676	3,017	(11.3)	3,329	(19.6)	0.6	-10bps	-17bps
NBFC	11,663	4,657	150.4	4,532	157.3	2.7	157bps	161bps
Others	24,135	18,693	29.1	14,243	69.5	5.5	112bps	219bps
Total Deposits	527,140	516,548	2.1	498,776	5.7	100.0	0bps	0bps
CA	45,770	47,351	(3.3)	43,536	5.1	8.7	-48bps	-5bps
SA	110,133	111,580	(1.3)	112,558	(2.2)	20.9	-71bps	-167bps
Term	371,237	357,617	3.8	342,682	8.3	70.4	119bps	172bps
Investments	156,882	NA	NA	146,779	6.9	NA	NA	NA
Investments/(Invest. + Net Adv.) (%)	26.9	NA	NA	25.9	95bps	NA	NA	NA
Borrowings	45,143	NA	NA	53,980	(16.4)	NA	NA	NA
Borrowings/(Borr. + Deposits) (%)	7.9	NA	NA	9.8	-188bps	NA	NA	NA

Source: Company, YES Sec – Research, *Share in Total and change in share

Exhibit 3: Key quarterly ratios

(%)	Q2FY24	Q1FY24	chg qoq	Q2FY23	chg yoy
Net interest margin	3.74	3.67	7bps	4.09	-35bps
Yield on advances	9.77	9.53	24bps	9.39	38bps
Cost of deposits	5.51	5.36	15bps	4.51	100bps
Loan to Deposit ratio	83.0	82.0	100bps	86.0	-300bps
Non-int. income / Total Income	25.3	26.8	-155bps	23.4	187bps
Fee Income to Avg. Total Assets	0.5	0.5	-1bps	0.5	2bps
Cost to Income ratio	46.3	42.0	436bps	38.4	791bps
Opex to Avg. Total Assets	2.0	1.8	20bps	1.8	23bps
RoA	1.7	1.4	29bps	1.7	-3bps
RoE	14.4	12.1	226bps	16.0	-162bps
Annualised Slippage Ratio	2.0	3.6	-160bps	2.4	-44bps
Provision coverage ratio	71.0	70.0	100bps	66.0	500bps
Gross NPA	4.7	4.9	-25bps	4.4	30bps
Net NPA	2.3	2.5	-17bps	2.7	-35bps
Capital adequacy ratio	22.2	23.0	-81bps	20.1	213bps
Tier I capital ratio	22.2	22.0	19bps	19.0	315bps

Source: Company, YES Sec – Research

Exhibit 4: Quarterly Actuals Vs Estimates

Q2FY24 (Rs. mn)	Actuals	Estimates	Diff, %
Net Interest Income	5,384	5,267	2.2
Pre-Prov. Operating Profit	3,866	4,183	(7.6)
Profit After Tax	2,806	2,200	27.6

Source: Company, YES Sec – Research

Exhibit 5: Operating Expense Break-up

(Rs mn)	Q2FY24	Q1FY24	% qoq	Q2FY23	% yoy
Employee Expense	1,582	1,322	19.7	1,412	12.1
Other Operating Expense	1,757	1,676	4.8	1,437	22.2
Total Operating Expense	3,339	2,998	11.4	2,849	17.2

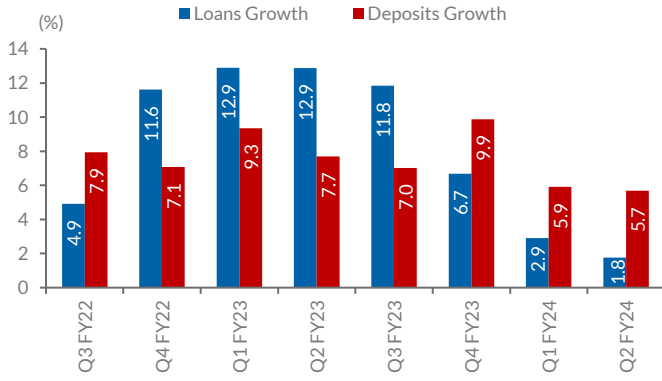
Source: Company, YES Sec - Research

Exhibit 6: Non-Interest Income Break-up

(Rs mn)	Q2FY24	Q1FY24	% qoq	Q2FY23	% yoy
Total Fee Income (A)	866	883	(1.9)	799	8.4
CEB and Charges	866	883	(1.9)	799	8.4
Total Other Income (B)	955	1,032	(7.5)	936	2.0
Treasury Income	268	405	(33.8)	455	(41.1)
Other Income (incl recoveries)	687	627	9.6	481	42.8
Total Non-Interest Income (A+B)	1,821	1,915	(4.9)	1,735	5.0

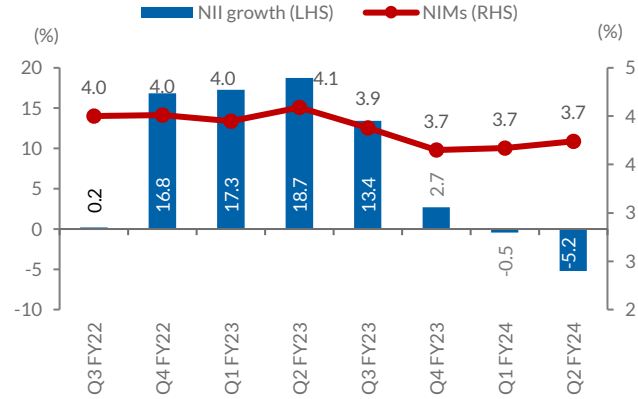
Source: Company, YES Sec - Research

Exhibit 7: Loans and Deposits growth (YoY %)



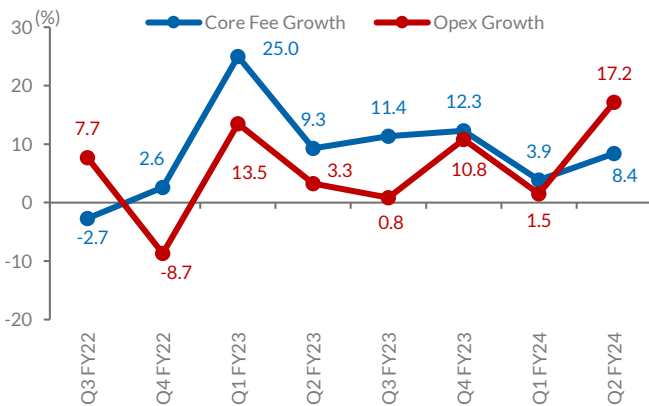
Source: Company, YES Sec – Research

Exhibit 8: NII growth (YoY %) and NIM (%)



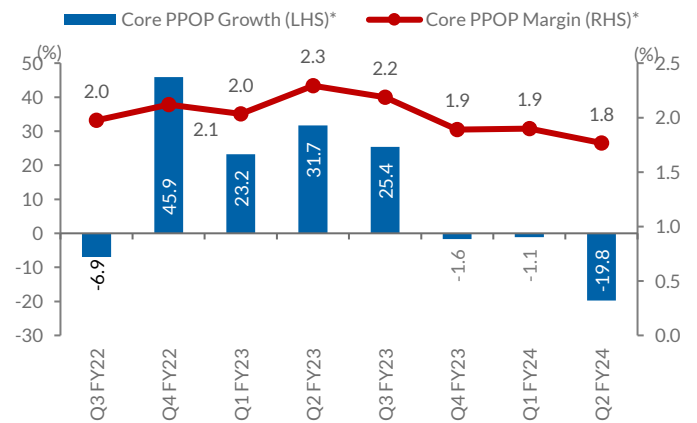
Source: Company, YES Sec – Research

Exhibit 9: Core Fee and Opex growth (YoY %)



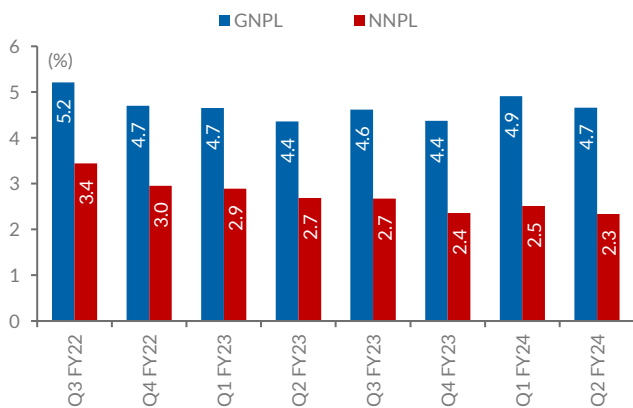
Source: Company, YES Sec – Research

Exhibit 10: Core PPOP growth (YoY %) and Core PPOP margin (%)



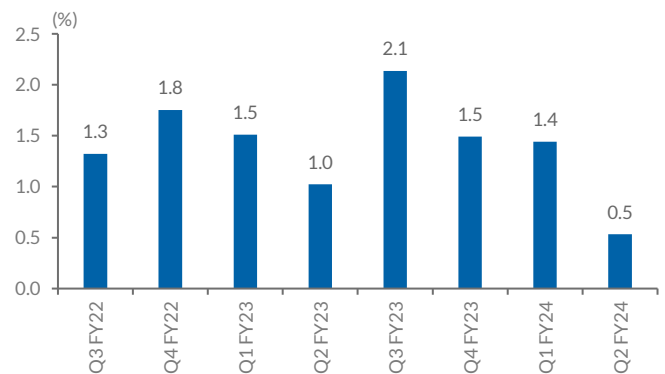
Source: Company, YES Sec – Research. * Core PPOP is derived by adjusting PPOP for gain/loss on sale of investments and misc. income

Exhibit 11: Gross NPA and Net NPA (%)



Source: Company, YES Sec – Research

Exhibit 12: Provisions/Average Advances (%)



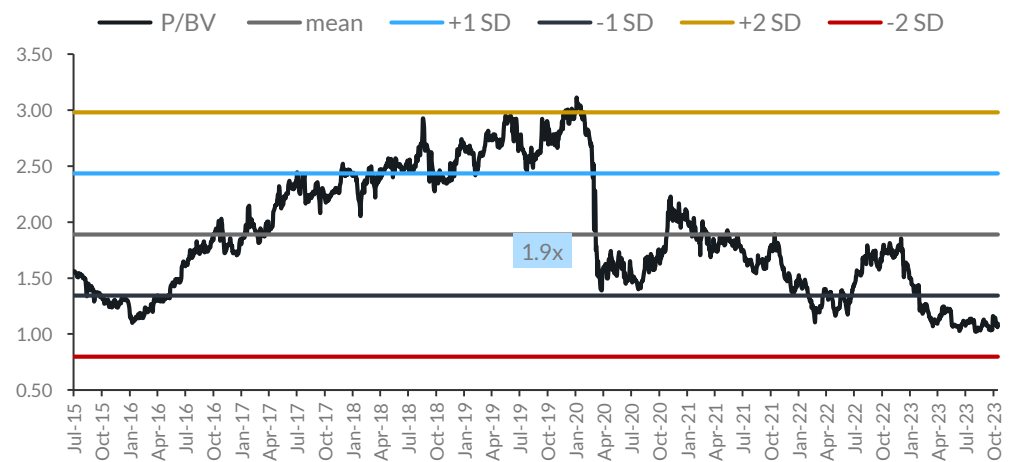
Source: Company, YES Sec – Research

Exhibit 13: 1-year rolling P/BV band



Source: Company, YES Sec - Research

Exhibit 14: 1-yr rolling P/BV vis-a-vis the mean and standard deviations



Source: Company, YES Sec - Research

ANNUAL FINANCIALS

Exhibit 15: Balance sheet

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Total cash & equivalents	66,869	66,493	75,137	86,407	99,368
Investments	122,212	143,326	157,573	173,244	190,482
Advances	403,585	430,533	486,503	559,478	643,400
Fixed assets	2,147	2,393	2,633	2,896	3,185
Other assets	20,496	23,200	27,840	33,408	40,089
Total assets	615,309	665,946	749,685	855,433	976,525
Net worth	65,857	74,572	84,005	95,282	108,325
Deposits	476,897	523,979	591,142	678,712	779,418
Borrowings	53,118	46,881	49,120	52,039	55,396
Other liabilities	19,437	20,514	25,418	29,401	33,386
Total liabilities incl. Equity	615,309	665,946	749,685	855,433	976,525

Source: Company, YES Sec – Research

Exhibit 16: Income statement

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	41,048	47,143	51,703	58,671	66,949
Interest expense	(21,883)	(25,515)	(28,983)	(32,746)	(37,403)
Net interest income	19,165	21,628	22,719	25,925	29,547
Non-interest income	7,591	8,104	8,769	10,283	11,742
Total income	26,756	29,732	31,488	36,208	41,289
Operating expenses	(10,803)	(11,552)	(12,741)	(14,321)	(16,167)
PPoP	15,953	18,180	18,747	21,888	25,122
Provisions	(6,102)	(6,405)	(5,589)	(6,677)	(7,674)
Profit before tax	9,852	11,775	13,158	15,211	17,448
Taxes	(2,250)	(2,400)	(2,763)	(3,194)	(3,664)
Net profit	7,602	9,375	10,395	12,017	13,784

Source: Company, YES Sec – Research

Exhibit 17: Du Pont Analysis (RoA tree)

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	7.1	7.4	7.3	7.3	7.3
Interest expense	-3.8	-4.0	-4.1	-4.1	-4.1
Net interest income	3.3	3.4	3.2	3.2	3.2
Non-interest income	1.3	1.3	1.2	1.3	1.3
Total income	4.7	4.6	4.4	4.5	4.5
Operating expenses	-1.9	-1.8	-1.8	-1.8	-1.8
PPoP	2.8	2.8	2.6	2.7	2.7
Provisions	-1.1	-1.0	-0.8	-0.8	-0.8
Profit before tax	1.7	1.8	1.9	1.9	1.9
Taxes	-0.4	-0.4	-0.4	-0.4	-0.4
Net profit	1.3	1.5	1.5	1.5	1.5

Source: Company, YES Sec – Research

Exhibit 18: Change in annual estimates

Y/e 31 Mar (Rs mn)	Revised Estimate			Earlier Estimate			% Revision		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Net Interest Income	22,719	25,925	29,547	22,719	25,925	29,547	0.0	0.0	0.0
Pre-Prov. Operating Profit	18,747	21,888	25,122	18,747	21,888	25,122	0.0	0.0	0.0
Profit after tax	10,395	12,017	13,784	10,214	12,017	13,784	1.8	0.0	0.0

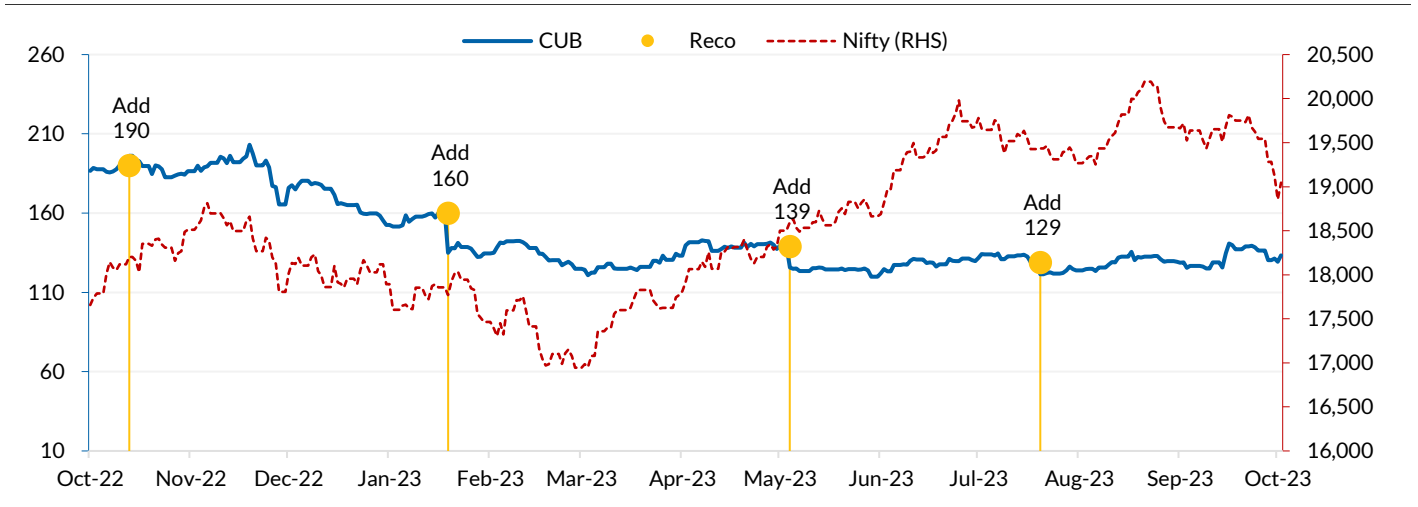
Source: Company, YES Sec – Research

Exhibit 19: Ratio analysis

Y/e 31 Mar	FY22	FY23	FY24E	FY25E	FY26E
Growth matrix (%)					
Net interest income	4.7	12.9	5.0	14.1	14.0
PPoP	8.7	14.0	3.1	16.8	14.8
Net profit	28.2	23.3	10.9	15.6	14.7
Loans	11.6	6.7	13.0	15.0	15.0
Deposits	7.1	9.9	12.8	14.8	14.8
Profitability Ratios (%)					
Net interest margin	4.0	3.9	3.7	3.7	3.7
Return on Average Equity	12.2	13.4	13.1	13.4	13.5
Return on Average Assets	1.3	1.5	1.5	1.5	1.5
Per share figures (Rs)					
EPS	10.3	12.7	14.0	16.2	18.6
BVPS	89	101	113	129	146
ABVPS	73	87	99	115	134
Valuation multiples					
P/E	13	10.5	9.5	8.2	7.2
P/BV	1.5	1.3	1.2	1.0	0.9
P/ABV	1.8	1.5	1.3	1.2	1.0
NIM internals (%)					
Yield on loans	9.0	9.1	9.1	9.1	9.1
Cost of deposits	4.6	4.6	4.7	4.8	4.8
Loan-deposit ratio	84.6	82.2	82.3	82.4	82.5
CASA ratio	32.6	29.9	30.0	30.0	30.0
Opex control (%)					
Cost/Income ratio	40.4	38.9	40.5	39.6	39.2
Cost to average assets	1.9	1.8	1.8	1.8	1.8
Capital adequacy (%)					
Tier 1 capital ratio	19.8	21.3	21.3	20.7	20.2
Asset quality (%)					
Slippage ratio	3.3	3.2	2.2	2.0	1.8
Gross NPL ratio	4.7	4.4	3.8	3.3	3.0
Credit cost	1.4	1.7	1.2	1.2	1.2
Net NPL ratio	3.0	2.4	2.2	1.8	1.5

Source: Company, YES Sec – Research

Recommendation Tracker



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