



BUY

Target Price:Rs 228

CITY UNION BANK

BFSI

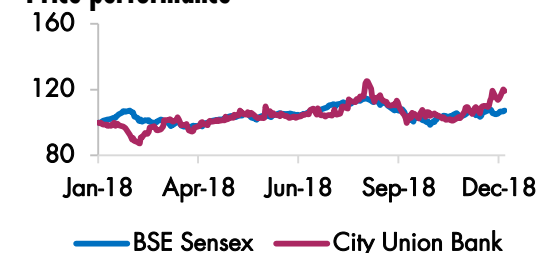
High Potential "CUB"

CMP :Rs 190
Potential Upside :20%

MARKET DATA

No. of Shares : 73.19 Cr
Market Cap : Rs 14,099.8 Cr
Free Float : 100%
Avg. daily vol (6mth) : 6,41,518 shares
52-w High / Low : Rs 207/ Rs 148
Bloomberg : CUBK IN
Promoter holding : —
FII / DII : 27.3/23.8%

Price performance



Key drivers

	FY18	FY19E	FY20E	FY21E
Loan Growth (%)	16.9	19.0	20.0	21.0
GNPA(%)	3.0	2.9	2.6	2.4
LLP (%)	1.2	1.2	1.0	0.9

Financial Summary

Y/E March *	NII (Rs mn)	PAT (Rs mn)	EPS (Rs)	EPS chg (%)	Book Value (Rs)	ABV (Rs)	PE (x)	P/ABV (x)	ROAE (%)	ROAA (%)	Net NPA (%)
FY17	11,988	5,028	8.4	13.1	59.4	52.6	23.2	3.7	15.2	1.5	1.7
FY18	14,303	5,920	8.9	17.7	62.6	55.4	21.8	3.5	15.3	1.6	1.7
FY19E	16,186	6,848	9.4	15.7	66.0	58.9	20.6	3.3	15.2	1.6	1.6
FY20E	19,022	8,125	11.1	18.6	76.7	68.0	17.4	2.8	15.6	1.6	1.6
FY21E	22,045	9,526	13.0	17.2	89.2	80.0	14.8	2.4	15.7	1.6	1.6

Source: Company, Axis Securities

CMP as on Jan 7, 2019

City Union Bank

Sector: BFSI

City Union Bank : High Potential "CUB"

CUBK (City Union Bank) is a mid-sized private sector bank focused largely on working capital finance to small manufacturers and traders. Unchanged strategies and organisation focus, adequate capitalisation, and management continuity are CUBK's key strengths. It has delivered steady performance on account of its conservative management, unparalleled lending franchise, tight control on asset quality, superior return ratios across cycles, healthy NIMs and a well capitalised balance sheet. Improving loan growth, diversified revenue profile, controlled C-I and lower credit costs should aid RoAA of +1.55% over FY18-21E. **Considering multiple levers, we assign 2.9x on FY21E ABV to arrive at target price of Rs 228.**

Conservative approach to growth a key strength

- ✓ CUBK has maintained its USP on product (working capital lending) and the customer base (SME, traders, agriculture, etc) despite the lure to do something different, unlike other lenders
- ✓ While increasing granularity to reduce concentration risk, the bank has ensured higher collateralisation to lower credit risk too

MSME/Trader/Retail to drive loan book growth

- ✓ We expect high double digit growth in loan book over FY18-21E, largely driven by MSME/Trader/Retail
- ✓ Focus on small-ticket sole banker business model, expertise in southern India's niche business segments, viz MSME, traders and agri loans, and struggling health of regional PSBs will drive higher loan growth

Control over C-I to be maintained

- ✓ Share of non-branch channels in transactions is ~90%, which is comparable with the best new generation private sector banks vis-à-vis ~60% a few years ago. This has been a key factor in sizing employees per branch from ~9-9.5 a few years ago to ~8.5, currently. Further gains can be beneficial for cost to income ratio (C-I)
- ✓ With marginal moderation in NIM and controlled opex we expect C-I to be in the range of ~40-42% over FY18-FY21E

Credit cost to decline with focus on lower slippages and recovery

- ✓ The bank's focus on small-ticket secured lending, working capital loans backed by adequate collateral restrict the slippages of NPA and also improve the NPA recoveries
- ✓ With slippages normalizing and recoveries gaining traction, we expect GNPA and LLP (Loan Loss Provisions) to decline by 60bps and 28bps to 2.4% and 0.9% respectively over FY18-21E
- ✓ ROAA profile to be maintained at +1.55% levels

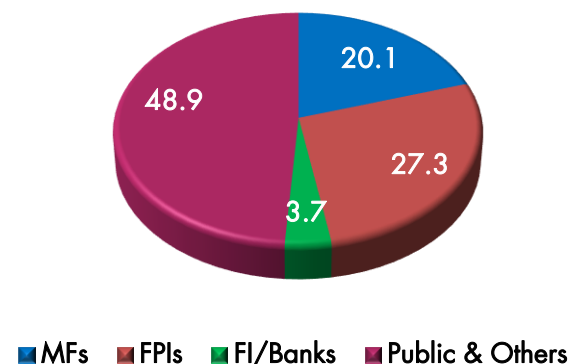
City Union Bank

Sector: BFSI

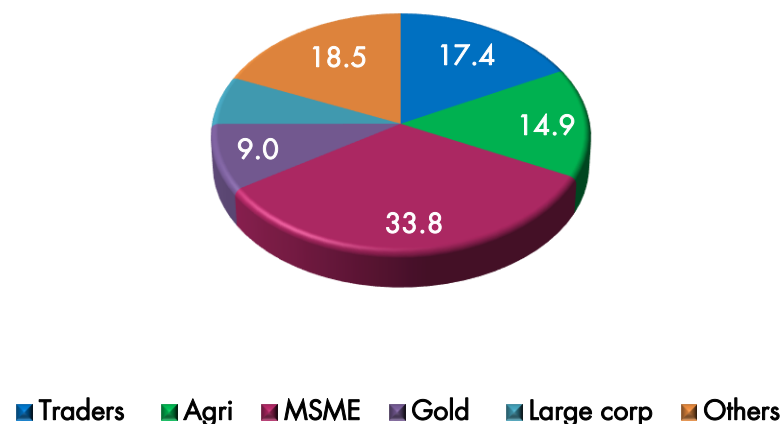
Company background

- City Union Bank (CUBK) was established in 1904 as Kumbakonam Bank Ltd in Tamil Nadu and is amongst India's oldest private sector banks. It has evolved into a strong regional player with major presence in South India, with 544 branches out of which 418 are in Tamil Nadu.
- CUBK has bancassurance tie-ups with LIC of India and National Insurance Company Ltd for selling their insurance products. It also has a tie-up with Exports Credit & Guarantee Corporation Ltd for marketing export credit insurance products through its branches. It is also in talks for mutual fund tie up offerings.
- The bank is primarily a working capital lender to MSME, retail/wholesale trade and agricultural sectors. This higher-yielding trade and MSME loans segment accounts for ~51% of advances and has registered compounded growth of 18.5% over FY11-FY18.
- CUBK's decades of experience in a single geographical region has helped it gain immense knowledge and understanding on the way local businesses are run. It has withstood a number of business cycles during the course of its existence.

Ownership Profile – Total Institution holding at ~51%



Loan Mix (%) - (Q2FY19)



Source: Company, Axis Securities

Company Overview

The bank has shown consistency in management with only seven CEOs being appointed in its entire 114-year history.

It was listed on the stock exchanges in 1998 under the leadership of its Chairman V Narayanan, who had tenure of 24 years at CUBK.

Name	Year
S. Mahalinga Iyer	1926-1963
R. A. Venkataramani	1963-1969
O. R. Srinivasan	1969-1977
K. Srinivasan	1977-1980
V. Narayanan	1980-2004
S. Balasubramanian	2005-2011
Dr. N. Kamakodi	2011-Present

Experienced Management Team

S. MAHALINGAM
Chairman

- Retired as CFO & ED of TCS in 2013 after 43 years of service
- Well known in the Indian IT industry

Dr. N. KAMAKODI
Managing Director & CEO

- Joined the bank as DGM in 2003 and has hands on experience of the overall operations of the bank
- Serving as MD & CEO of the Bank from May 2011

V. RAMESH
CFO & GM

- Joined CUBK in 1986, worked his way up to July 2015
- CFO since July 2015

Source: Company, Axis Securities

Conservative and Consistent approach towards lending

Niche focus
maintained

High
collateralization -
increases solvency

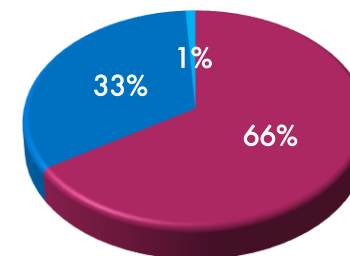
Granular
Loan Book

Conservative and Consistent approach towards lending

Niche focus maintained

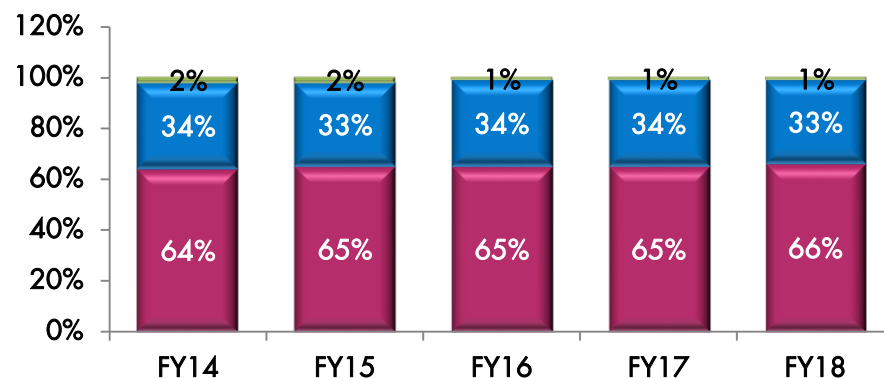
- Over FY03-13, CUBK delivered 29% CAGR in loans maintaining ~60% average lending through working capital and the rest comprised term loans. Post a growth moderation over the next couple of years due to slowdown in non core segments, loan growth gained momentum over FY15-FY18 registering 15% CAGR.
- CUBK has focused on remaining the sole banker or part of small group of banks (maybe 2-3 banks); maintaining low-ticket sizes; and increasing collateralisation in these loans.
- Most lenders have changed their focus from either the product or the customer or both over the long periods of their history, due to challenges e.g. corporate. CUBK, on the other hand, has maintained a disciplined and stable approach to lending entailing focus on MSMEs and more specifically on their working capital requirement.
- Working capital loans yielding higher interest constitute 66% of advances. Re-pricing is possible at short intervals thus reducing interest rate risk. 95% of the loan book is on floating rate basis which also reduces interest rate risk.

Loan Book – Product Composition



■ Cash Credit & Demand Loans ■ Term Loans ■ Bills Purchased & Bills Discounted

Specialist in working capital finance



■ Cash Credit & Demand Loans ■ Term Loans ■ Bills Purchased & Bills Discounted

Source: Company, Axis Securities

Conservative and Consistent approach towards lending

High collateralization - increases solvency

- Secured loans comprised 98% of total loans as of FY18. This has provided it niche positioning, strong SME relationships, and better customer acquisition through referrals, and has lowered credit risks.
- CUBK has ensured higher collateralisation of loans even as its growth has been to smaller MSME customers lowering concentration risks and granular loan book.
- From FY10 to FY15, the mix of unrated exposure in total exposure increased from 89% to 96%. However, the proportion of exposures attracting 'less than 100% risk weight' increased from 61% to 67% over the same period, indicating that these exposures have higher collateral, therefore lowering overall credit risk. Over FY15-FY18, the mix of unrated exposure in total exposure has remained at 96% while the 'less than 100% risk weight' has come down moderately from 67% to 63%, keeping credit risks at comfortable levels.
- Advances to major industries constitute only 24% of its loan book and 76% comprises of largely Trade, Services, Agri, Gold etc. CUBK uses its long standing relationships, its understanding of these clients and catering to specific customer needs to attract new clients.

Secured and Working Capital Loans (%)



Advances to major industries (FY18)

Industry Name	Amt (in mn)	% of Total Advances
Advances to Major Industries	68,278	24%
All other advances	213,873	76%
Total Gross Advances	282,151	100%

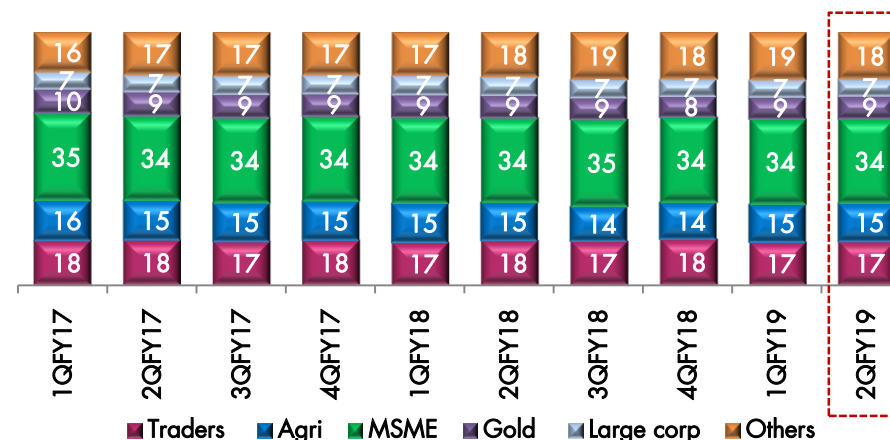
Source: Company, Axis Securities

Conservative and Consistent approach towards lending

Granular Loan Book

- ♦ CUB's loan growth of ~9% CAGR over FY13-15 can be attributed to a decline in the gold loan portfolio (regulatory impact) and the corporate portfolio (conscious strategy). Excluding these, loan growth was +21% for FY13-15, driven by core focus segments like MSME.
- ♦ Over the next three years (FY15-FY18), loan growth picked up again clocking 15% CAGR. In Q2FY19 CUBK's loan growth of ~17% YoY was broad based with Personal Loans (+61% YoY) and retail traders (+22% YoY) leading the pack. Strong traction continued in the bank's focus segments - Traders (+16% YoY) and MSME (+17% YoY). The bank's cautious stance on corporate lending continued as the segment grew merely ~8% YoY. The share of MSME and traders' loans was steady at ~51% of total loans.
- ♦ *Focus on small-ticket sole banker business model, expertise in southern India's niche business segments, viz MSME, traders and agri loans, and weak health of regional PSBs will drive higher loan growth. Comfortable Tier-I position and pick-up in macro activities are strong tailwinds. We have factored in a loan CAGR of 20% over FY18-21E.*

Diversified book



Loan book CAGR at 20% over FY09-FY18



Source: Company, Axis Securities

Regional focus in MSME segment – Improved market share

Credit growth in
TN revives

Regional banks –
preferred choice for
MSME

Regional focus in MSME segment – Improved market share

Credit growth in Tamil Nadu revives

(Rs bn)	FY13	FY14	FY15	FY16	FY17	FY18
Branches	8,041	8,841	9,496	9,971	10,501	10,612
Growth (% YoY)	8.6	9.9	7.4	5	5.3	1.1
Deposits	4,446	5,082	5,441	5,968	6,651	7,177
Growth (% YoY)	3.6	14.3	7.1	9.7	11.4	7.9
Advances	5,335	6,056	6,499	6,828	6,955	7,847
Growth (% YoY)	18.8	13.5	7.3	5.1	1.9	12.8
Priority sector Advances	2,111	2,430	2,664	3,002	3,161	3,565
Growth (% YoY)	19.6	15.1	9.6	12.7	5.3	12.8
Agri	982	1,077	1,207	1,246	1,353	1,568
Growth (% YoY)	25.6	9.7	12.1	3.2	8.6	15.9
MSME	686	869	962	1,178	1,244	1,403
Growth (% YoY)	10.6	26.7	10.7	22.5	5.6	12.8
Housing	262	293	304	320	320	306
Growth (% YoY)	9.7	11.8	3.8	5.3	-	-4.4
Others	181	191	191	258	244	288
Growth (% YoY)	45.7	5.5	-	35.1	-5.4	18
Non Priority Sector	3,225	3,626	3,835	3,826	3,794	4,282
Growth (% YoY)	18.2	12.4	5.8	-0.2	-0.8	12.9

Credit growth in Tamil Nadu for FY18 revived to 13% YoY; highest in past four years

Source: Company, Axis Securities

Regional focus in MSME segment – Improved market share

Regional banks – preferred choice for MSME

- ♦ CUBK's advances portfolios based in home state stands at ~69% as at Sep'18. CUBK is amongst top-5 private banks in Tamil Nadu with market shares of ~3.4% (Q1FY19) vs. aggregate other private banks share at ~24%. Given the bank's strategy to deepen presence in the state, CUB will gain market share from the weaker PSBs which have ~26% branch network share. We expect the bank's understanding of local businesses, relationships and knowledge of the niche business segments in southern India to support this expansion.
- ♦ MSME players suggest that regional banks are better placed than other financial intermediaries i.e. new private sector banks, public sector banks, NBFCs, MFIs and upcoming small banks, in their respective geographies. According to them, due to personal attention to their needs, access to top management and quick turnaround time as compared to other large banks, first choice for banking will be regional banks in the respective home states.

CUBK State-wise branch network

Branch State Wise (%)	FY15	FY16	FY17	FY18	Q2FY19
Tamil Nadu	68.2	68.4	68.9	69.2	68.9
Telengana	4.2	4.8	4.7	4.5	4.9
Seemandhra	7.6	7.2	6.9	6.5	6.4
Karnataka	5.5	5.3	5.5	6.0	5.9
Maharashtra	3.6	3.2	3.1	3.2	3.3
Kerala	3.2	2.9	2.9	2.7	2.6
Gujarat	1.9	2.1	2.0	1.8	1.8
Others	5.9	6.1	6.0	6.2	6.1

Source: Company, Axis Securities, RBI

MSME Lending - Opportunities in India

Private Banks
improve market
share

MSME - the new
lending sweet spot?

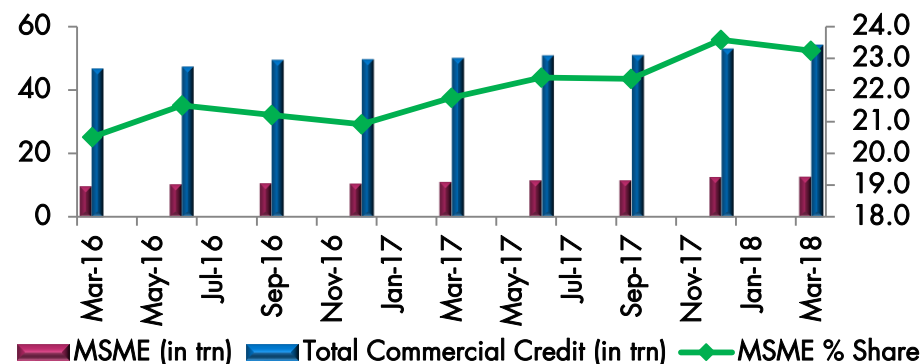
MSME Lending - Opportunities in India

Private Banks improve market share

- As per the International Finance Corporation, the total financing demand of Indian MSME sector is Rs 32.5 trillion (Source: KPMG). As on March 18, the total on-balance sheet commercial lending stood at Rs 54.2 trillion with MSME segments constituting 23% - Rs 12.6 trillion.
- Private Banks and NBFCs have increased their market share in Micro and SME lending from 27.5% and 9.1% in March 2017 to 30.3% and 10.9% in March 2018. Share of PSBs has fallen from 57% to 50.4% in the same period.
- Large Banks hesitate to grant loans due to high-risk perception from lack of financial transparency, high administrative costs of small-scale lending, and lack of collateral. Another reason is high mortality rates of MSMEs—financial institutions are doubtful about their survival and growth and, therefore, under-financing happens. With this regard, specialist players like CUBK with their understanding of local businesses are on strong footing. Also, the advent of GST will help MSME to improve systemic data.

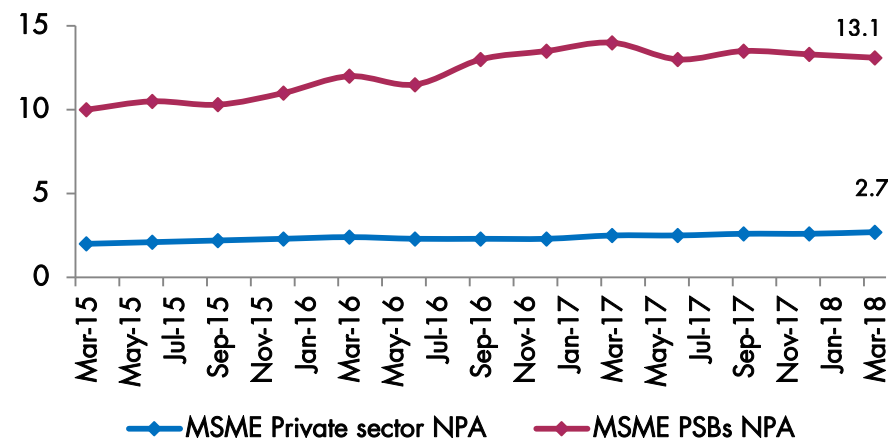
Source: Company, Axis Securities

Credit to MSME improving yet gap to overall demand remains



Source: MSME Pulse Report

NPA (%) in MSME higher in PSBs

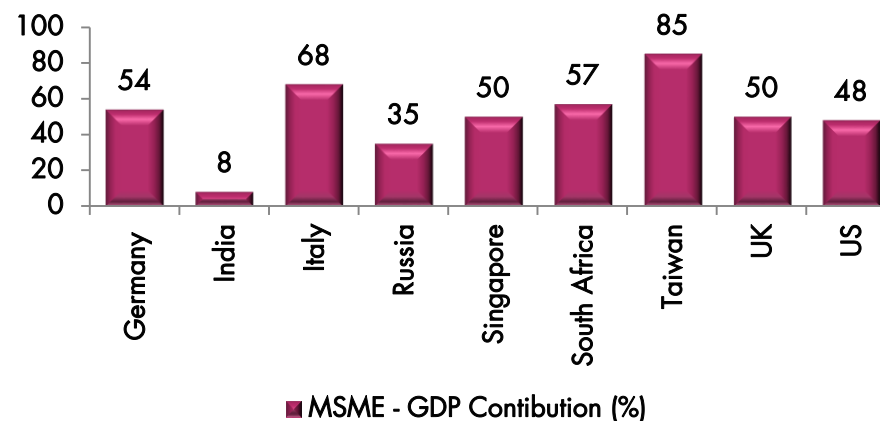


MSME Lending - Opportunities in India

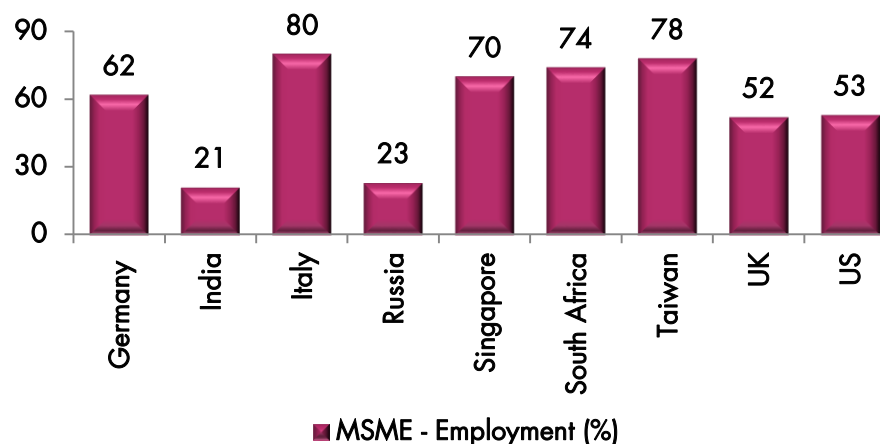
MSME – new lending sweet spot?

- Bank credit to MSMEs as a percentage of GDP in India is around 8%— far less compared to developed economies where it stands at +50% of GDP.
- MSMEs contribute significantly to employment, entrepreneurship and growth in the economy. They remain, by their predominantly informal nature, vulnerable to structural and cyclical shocks, at times with persistent effects. So local lending knowledge helps.
- Banks need to look at new segments that can drive growth the same way retail did in the past. The MSME sector, which is the second largest employer after agriculture, is emerging as a lending sweet spot.
- CUBK's management stated that they are gradually seeing their MSME customers trying to add capacity or increase their scale of business. Also, some customers are migrating from PCA banks or larger banks where their requirements are not fulfilled.

MSME GDP contribution in India low



Employment - MSME sector



Source: Company, Axis Securities

CASA aligns to business model

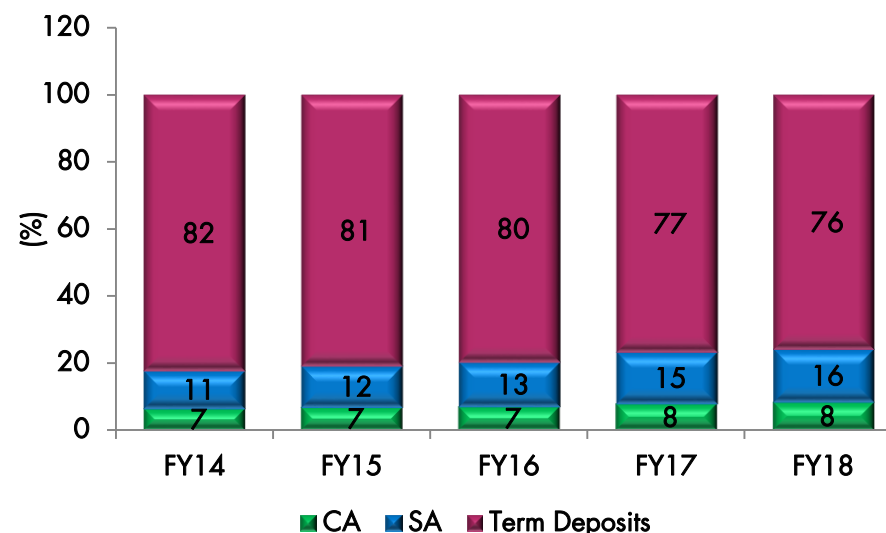
CASA to remain in
moderate range

CASA aligns to business model

CASA to remain in moderate range

- ◆ CUBK funding model has been to keep CASA ratio low and has been in the range of 16-24% over FY06-18. Term deposits comprised entirely of retail deposits with no differential rate deposits and forms almost 80% of overall deposits.
- ◆ In Q2FY19, the bank's overall deposits jumped ~12% YoY largely owing to robust accretion (+15% YoY) in CASA deposits. CASA formed 23.6% of deposits.
- ◆ We believe CASA ratio will continue to remain low due to the business model. CUBK faces natural impediments to high growth in CASA since firstly 418 of CUBK's 607 branches are located in a credit intensive state such as Tamil Nadu with a C/D (Credit/Deposit) ratio of 108% as of FY18 and secondly the branches are in industrial clusters where retail SA opportunities are lower.
- ◆ CUBK is unlikely to change anything materially about its deposit mobilization strategy and its deposit mix.
- ◆ The management stated that the cost of deposits is expected to increase. Till now, downward re-pricing of legacy high-cost deposits had helped cushion the impact.

Funding structure to remain dependent on retail term deposits



C/D in some credit intensive states

Branch State Wise	FY18	Q2FY19	State C/D ratio
Tamil Nadu	415	418	108%
Telangana	27	30	106%
Karnataka	36	36	70%
Maharashtra	19	20	105%
Kerala	16	16	156%
Gujarat	11	11	75%

Source: RBI

Source: Company, Axis Securities

Steady NIM

NIM maintained
across cycles

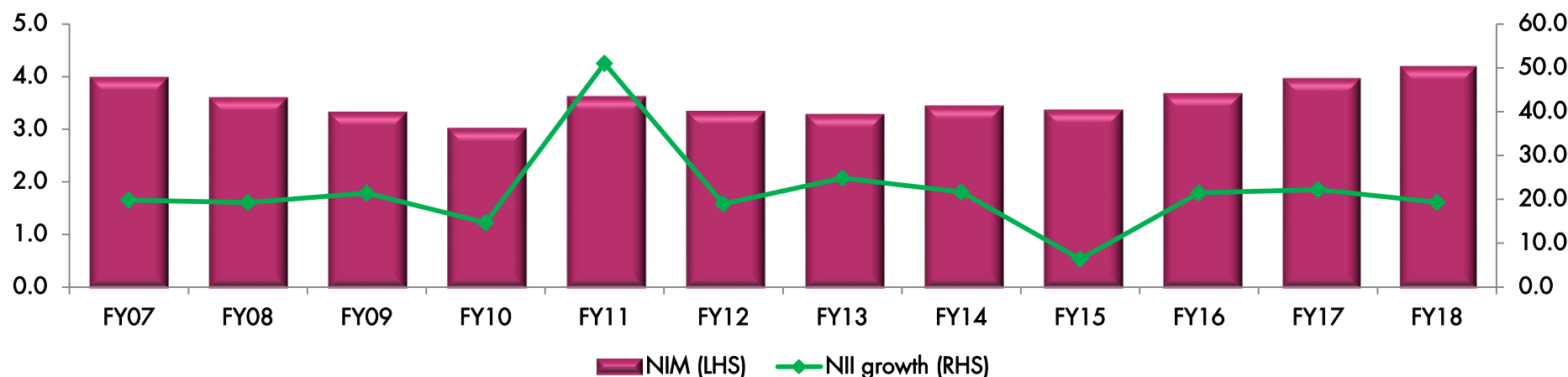
Non-interest income
sustains

Steady NIMs

NIMs maintained across cycles

- ♦ CUBK has maintained its NIMs at +3%. Over FY15-FY18, NIM has gradually increased from 3.34% to 4.16% led by lower slippage rates and decline in cost of funds. In the first half of FY19, after a 12bps compression in Q1, CUBK's NIM bounced back to 4.32%, led by drop in CoF, as the term deposits were repriced at lower rates coupled with steady yields and rise in the C-D ratio.
- ♦ CUBK's focus on the MSME and trader segments results in customer loyalty and will continue to yield pricing power. However, we expect marginal pressure on yields which coupled with bottoming out of cost of funds will moderate NIMs. Additionally, with 66% of the book consisting of high yielding working capital loans, and 95% linked to floating rates the drop in NIMs will be gradual. Despite conservative management guidance, we have maintained our NIM assumptions at ~3.8-4% over FY19-21E.

NIMs at +3% maintained



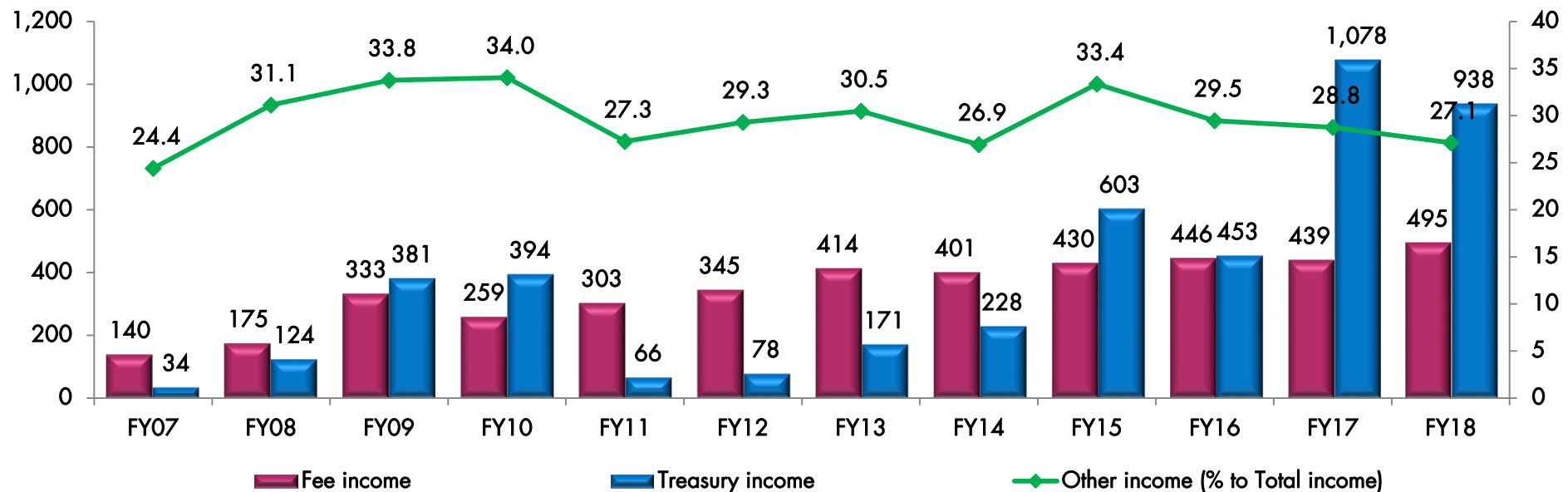
Source: Company, Axis Securities

Steady NIMs

Non interest income sustains

- ♦ Contribution from non-interest income to overall income has largely sustained at ~27-33%. The bank has also expanded its fee-based offerings to include slightly more sophisticated cash management and transaction banking offerings, which may improve fee income.
- ♦ We expect growth in non interest income to follow the bank's credit growth trends.

Non interest income ~1/3rd of Total Income



C-I : Operating leverage to sustain

Opex additions
streamlined

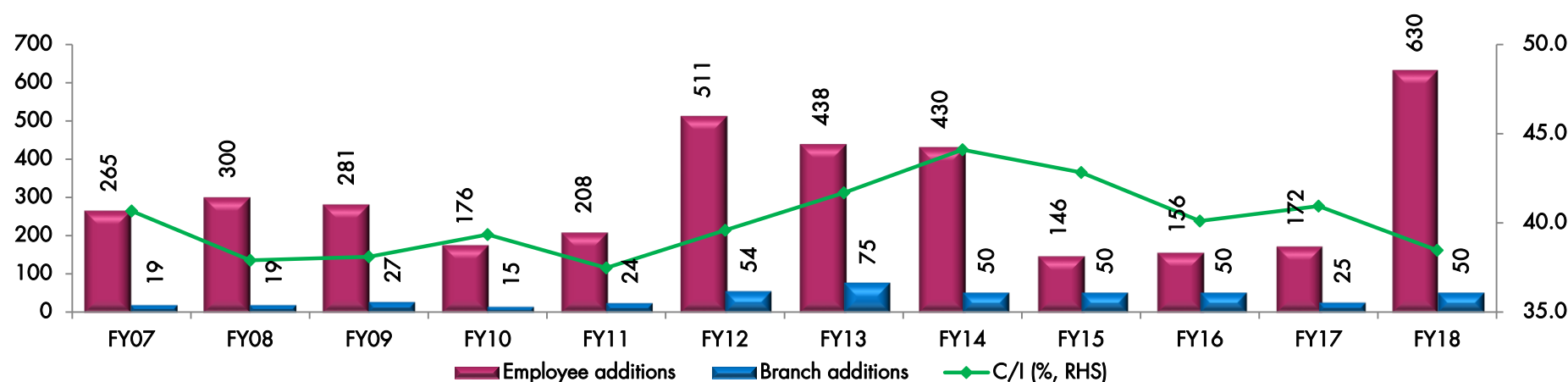
Digital push lowers
TAT

C- I : Operating leverage to sustain

Opex additions streamlined

- During FY12-15, the bank doubled its network to 475 branches and the employee base 1.5x to ~4,300. This resulted in higher opex CAGR (+23%, driven by 20% CAGR rise in staff cost). With ~70% of the branches in rural and semi-urban regions, the bank had relatively higher break-even period.
- CUBK undertook focused effort to increase penetration of its internet and mobile banking applications. It was also diligent in making use of the RBI incentive to install cash recyclers across branches. This freed up branch staff, enabling migration of ~80% of cash receipts to machines. As a result, CUBK was incrementally able to opt for smaller branches with lower rent, fewer employees per branch and faster branch breakeven.
- The decline in C-I or cost/income ratio over FY15-18 has been 468bps, with the exit C-I ratio in FY18 being 40.4%. This sharp decline was the outcome of slowdown in branch and employee addition, improving productivity and development of alternate delivery channels.

Slowdown in Branch/Employee additions coupled with digital push improved C-I



Source: Company, Axis Securities

C- I : Operating leverage to sustain

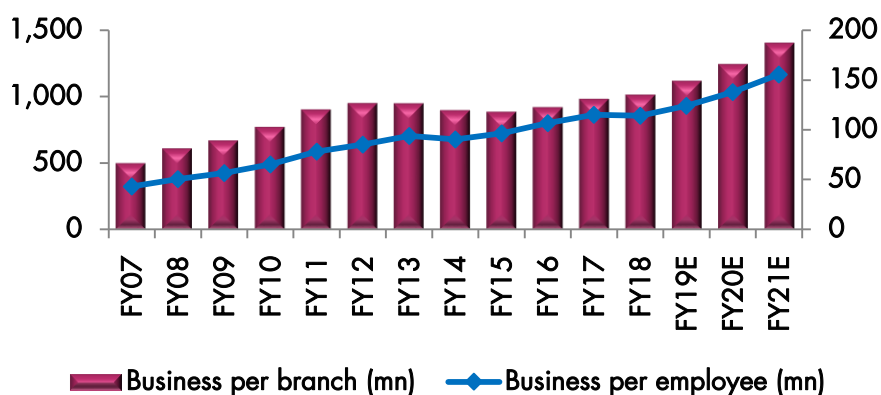
City Union Bank

Sector: BFSI

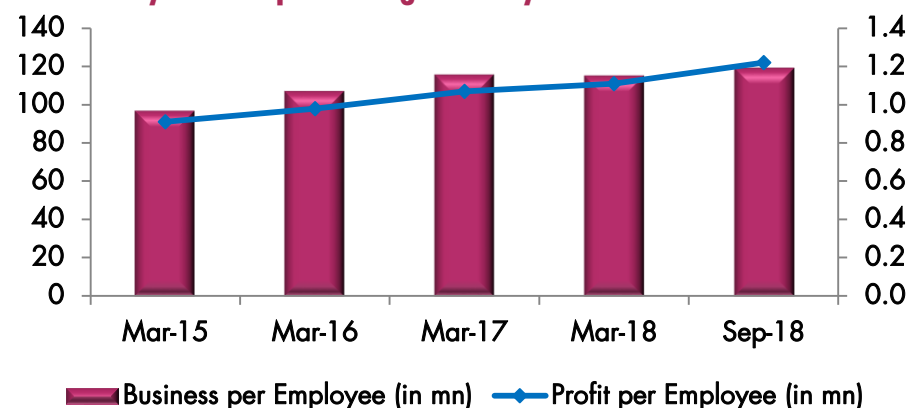
Digital push lowers TAT

- ♦ In terms of the number of transactions, the bank's non-branch channels have a share close to 90%, i.e., at similar levels to new generation banks. It is this digital strategy traction that has aided in the employees per branch metric to decline from ~9-9.5 to ~8.5 in the last few years.
- ♦ The bank wants to add value through the digital route and are following a combination approach in which data collection and analysis is automated, while the final decision is manual. Their credit disbursal technology is able to carry out automatic credit appraisal for ticket sizes up to Rs1.5-2mn. The advent of GST will help in creating data on which better analytics and sourcing can be based. Turn around time (TAT) has reduced and in some cases the reduction has been from 60mins to 15mins.
- ♦ Management expects trendline medium term C-I ratio to remain in the range of 40-42% barring impact from fluctuation in other income. After the cyber fraud which took place through SWIFT (in CUBK), the management stated that they were able to restrict the damage and have subsequently added multiple levels of security.

Branch and employee efficiency on the up



Productivity have improved significantly



On the mend - Asset Quality

Asset quality to improve

Restructured
pool consistently
coming down

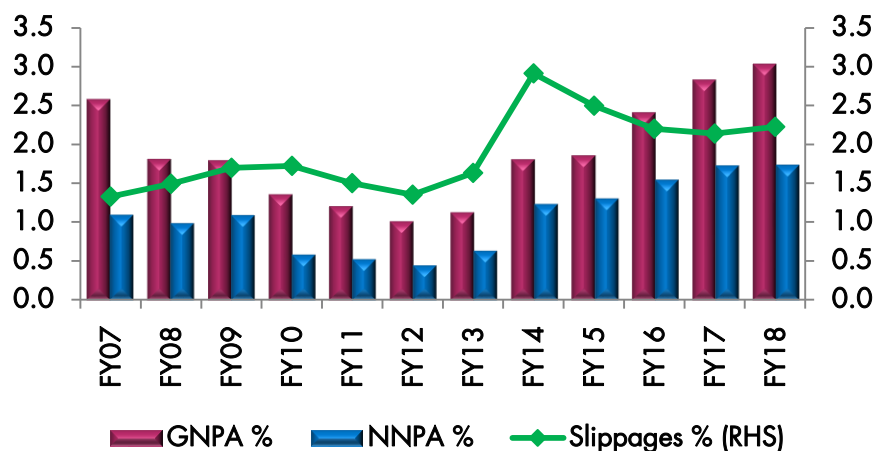
Concerns on asset
quality addressed

On the mend – Asset quality

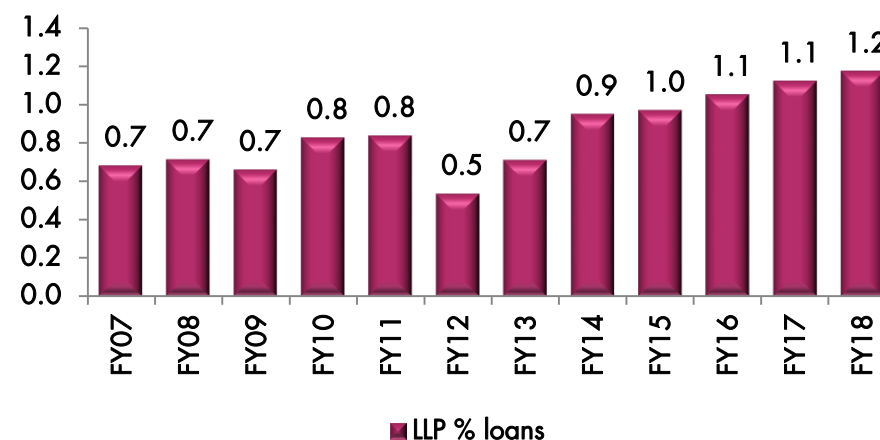
Asset quality to improve

- ♦ CUBK has had an adverse asset quality experience given an increase in GNPA's from 1.86% in FY15 to 3% in FY18. The increase was accompanied by higher write-offs, but for which headline GNPA's would have been higher. Delinquency ratio increased to 2.9% in FY14 and declined thereafter to 2.2% as of FY18. CUBK benefited from not having a large number of consortium-based exposures or large term lending versus mid-sized and larger peers. Despite this, stress did emerge in iron and steel, power, textiles, and sugar, etc.
- ♦ The bank's underwriting practices, strong relationships and expected tailwinds of improving macros give us confidence that the worst of stressed asset additions is behind. We expect asset quality to stabilise given the unlikely occurrence of high slippages from the iron and steel industry, as ~60%+ of the exposure is impaired, a low Restructured pool of 1.3% and no major exposure to large leveraged corporates.

Stressed asset additions come down



Loan loss provisions (LLP) as % to average loans



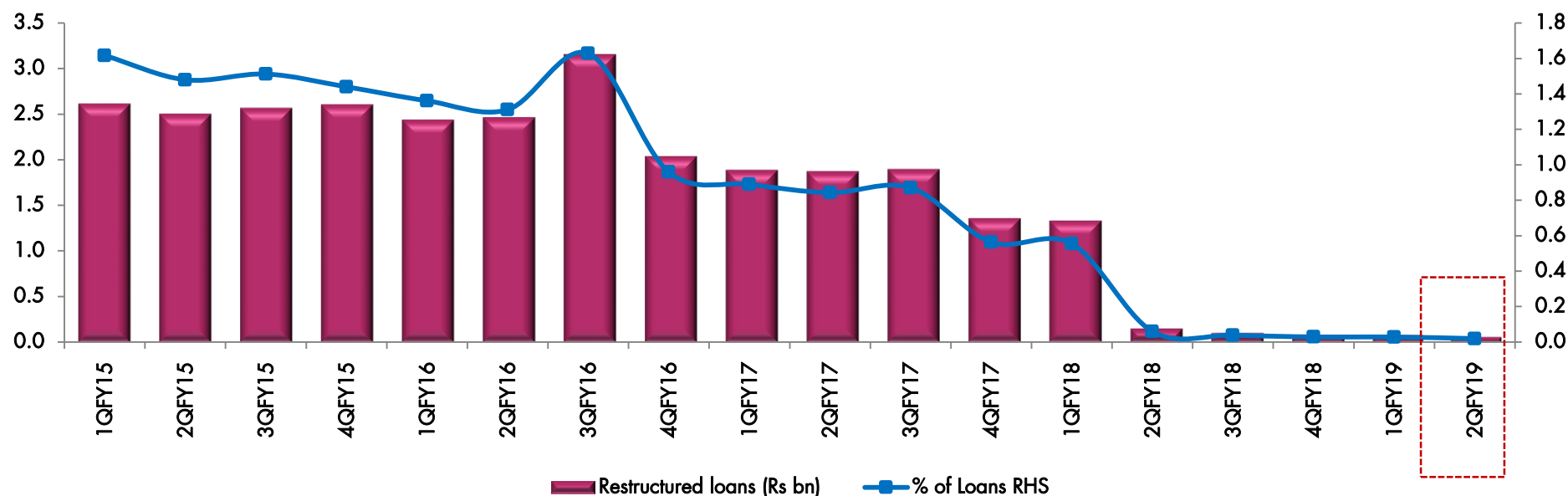
Source: Company, Axis Securities

On the mend – Asset quality

Restructured pool consistently coming down

- In Q2FY19, CUBK's net stressed book (restructured + NNPA's) was stable QoQ at 1.71% and down 10bps YoY. GNPA's were flat QoQ at Rs 8.5bn (2.85%) with lower slippages at Rs 1.36bn (1.88% ann. vs. 1.78% QoQ and 2.4% YoY). Only 2 accounts above Rs 100mn (Steel trading and oil trading co) slipped in Q2. The aggregate recoveries/upgrades jumped 48% YoY to Rs 685mn (+7% QoQ) as collateral realization improved. The write offs were higher at Rs 736mn vs. Rs 690mn QoQ. The management has cautioned on a single exposure in the Paper sector (Rs 800-850mn). However, they maintained their slippage guidance of 1.75-2% for FY19. For FY19 our slippage assumptions are ~1.9% and is expected to taper off over FY20-21E.

Restructured book at an all-time low



Source: Company, Axis Securities

On the mend – Asset quality

Concerns on asset quality addressed

- ♦ There have been 2 relatively large accounts (of exposure greater than Rs 500mn) that have been under stress. One is from the paper sector (underlying asset is paper mill) and another is an education institution.
- ♦ On the educational institution account with an exposure of Rs650-700mn, some properties were sold leading to that account coming out of stress.
- ♦ On the paper asset exposure of Rs800-850mn, the management stated that the working capital gap on the paper asset amounts to Rs400-450mn. Overall, the management is still hopeful on the account.
- ♦ Even if the large paper account slips, the banks re-iterates its full year FY19 slippage ratio of 1.75-2%.
- ♦ CUBK does not have any direct exposure to IL&FS group or other NBFCs.
- ♦ We estimate overall stress levels to come off as improvement in credit growth, lack of consortium level challenges, and adequate control over own smaller-ticket accounts allow CUBK to stem the flow of NPAs or recover outstanding debt. In terms of concentration risk, as highlighted earlier, CUBK is well placed with respect to peers. The proportion of top four NPA accounts or top twenty loan accounts is low at 0.41% and 6.87% respectively.

Return ratios comfortable

ROAE at +15% over
last 3 years

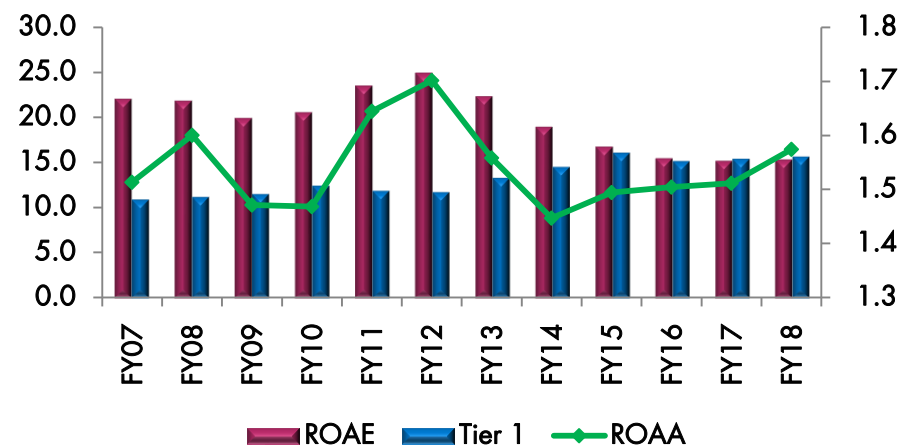
ROAA at +1.5%,
best amongst peers

Return ratios comfortable

Adequate capital cushion

- ◆ CUBK's ROAE averaged +20% over FY03-13. However, after FY14, ROAE declined and is currently at 15.3%. The decline was attributable to drop in ROAA; slowdown in loan growth and decline in leverage due to capital raising. At 15.6% Tier 1 ratio, CUBK has adequate capital cushion, which needs to be deployed to improve return ratios. Any adverse risks notwithstanding, we believe capital is sufficient for next couple of years.
- ◆ ROAA has been largely consistent at +1.5% (except FY14 – 1.4%) over FY07-FY18 and is the best among peers.
- ◆ While management is fairly risk averse currently, a change in the operating environment would give it confidence to grow its loan portfolio faster which will be positive for the stock.

ROAE at 15% over last 3 years



Capital raising history

Date	Capital raised (Rs Mn)	Issue px	Reason
29/3/2007	202	16.9	Preferential issue
08/10/2007	304	16.9	Preferential issue
08/10/2007	950	19.0	Preferential issue
29/12/2009	480	6.0	Rights Issue (1:4)
11/01/2013	2,580	20.0	Right Issue (1:4)
22/07/2014	3,500	75.1	QIP

Source: Company, Axis Securities

CUBK's Operational Performance

Stable loan growth...

Lower LLP to aid
earnings ...

Improved Asset
quality ...

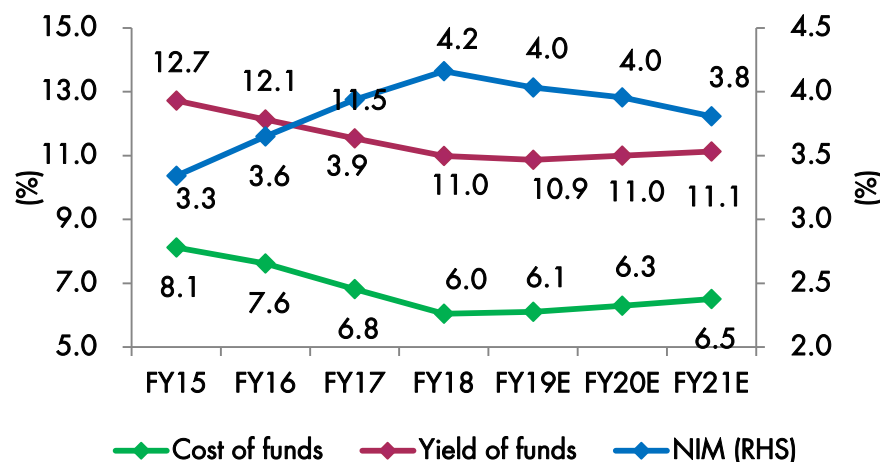
ROAA sustained

CUBK's Operational Performance

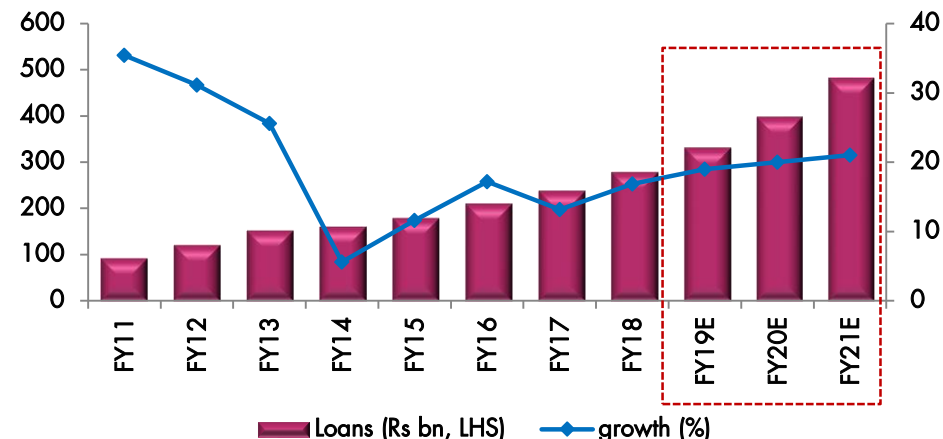
Stable loan growth, lower LLP to aid earnings ...

- ♦ We expect loan CAGR of 20% over FY18-FY21E led by growth in MSME, Traders following favourable domestic factors and increase in market share.
- ♦ Spread could moderate over the next couple of years with bottoming of cost of funds. NIMs could be in the range of 3.8-4%. LLP is expected to taper down to >1% over FY18-FY21E on lower stressed additions. This will translate into 16/12/17% CAGR in NII/PPOP/PAT over FY18-21E.

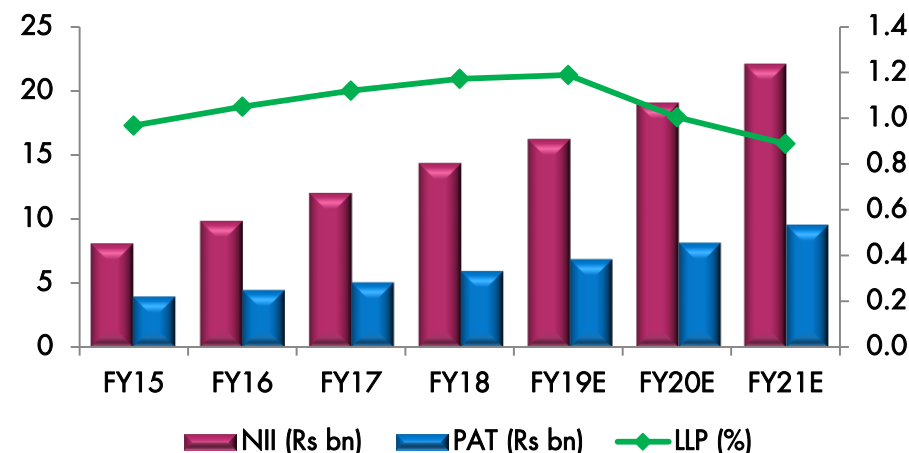
NIM to be at +3.5%



Overall loan growth to be led by MSME



Lower LLP to aid earnings



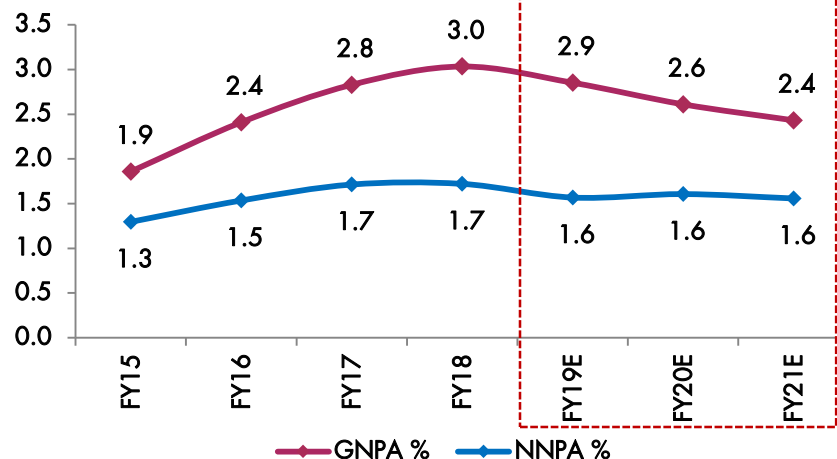
Source: Company, Axis Securities

CUBK's Operational Performance

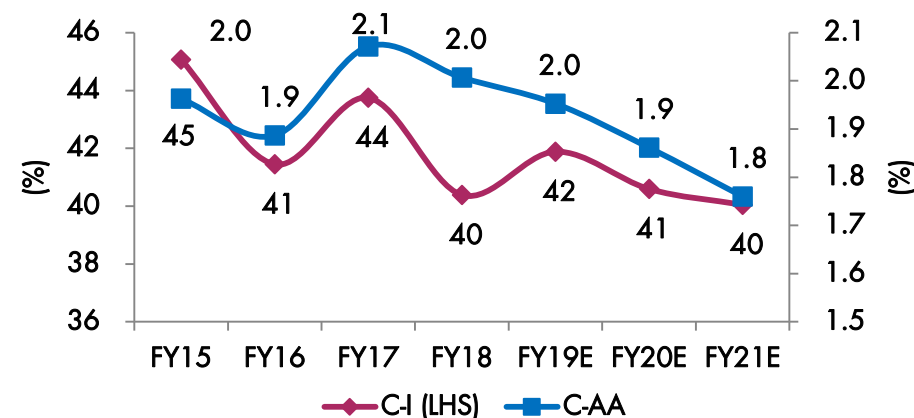
Improved Asset quality, ROAA sustained...

- Worst in terms of asset quality could be over by Q3/Q4FY19 and we expect GNPA/NNPA to come down gradually over FY19-21E. Lower exposures to stressed segments will reduce the probability of future unexpected surprises.
- Improvement in business growth, cost efficiencies and lower provisioning requirements are expected to sustain RoAA at +1.55% over FY18-21E.

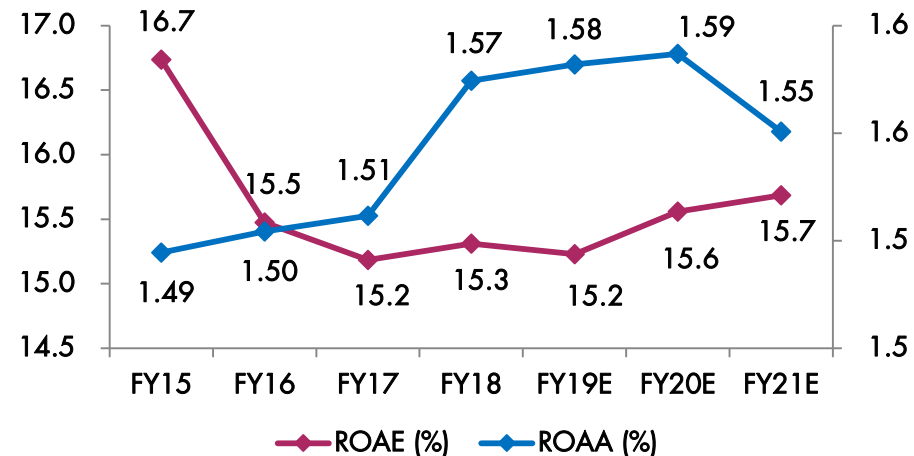
Asset quality to improve



C-I to be in control



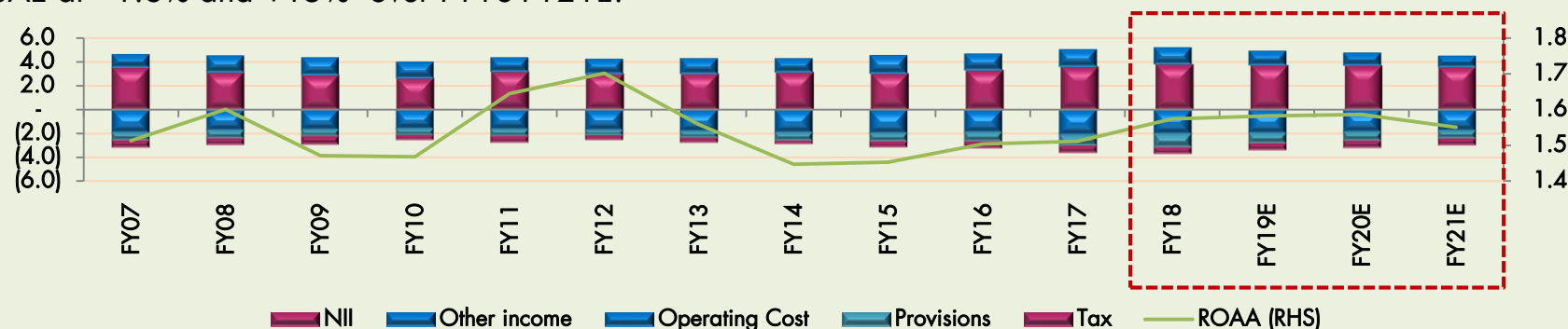
ROAA at +1.5%



Source: Company, Axis Securities

Outlook & Valuation

- Asset quality and growth issues are being addressed gradually. CUBK will benefit from its increasing loan book led by better traction in MSME/Trader/Retail segments. Its focus on small-ticket secured lending has helped to maintain sound asset quality in the past few years despite the industry being under severe asset quality stress. Its focus on lower slippages through better NPA management (99% of its loan book is secured) and higher recovery will lead to declining credit cost over next couple of years. We believe that with gradual improvement in the macros, a well-capitalised balance sheet and weak position of regional PSBs, CUBK is well placed to step on the growth pedal.
- We forecast 17% earnings CAGR over FY18-21E. The bank will continue with its higher return profile, with RoAA & RoAE at ~1.6% and +15% over FY18-FY21E.



- CUBK, over last few years, has witnessed relatively better and stable valuations owing to consistent return profile vis-à-vis mid-sized private bank peers. We believe, CUB with superior NIM, best return profile, grip on asset quality with greater bottom-line visibility over the medium term should continue to fetch higher multiple. **Initiate BUY with a Target Price of Rs 228/sh (2.9x FY21E ABV).**

Source: Company, Axis Securities

City Union Bank

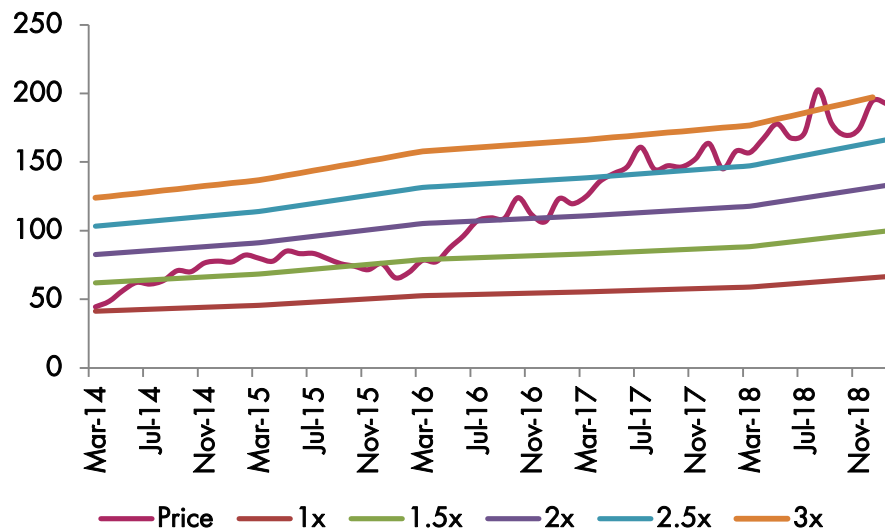
Sector: BFSI

Peer Comparison & Key Risks

Peer Comparison (In mn)

Company	Mcap	PAT	GNPA (%)	ROA (%)	ROE (%)	BVPS	P/BV
City Union Bank	142,425	5,920	3.0	1.6	15.3	62.6	3.0
South Indian Bank	28,141	3,345	3.6	0.4	7.0	27.7	0.6
Federal Bank	184,772	8,791	3.0	0.8	8.3	63.2	1.5
DCB Bank	52,164	2,456	1.8	0.9	10.9	86.6	2.0
Karur Vysya Bank	71,138	3,454	6.6	0.5	6.1	79.3	1.1

P/ABV SD Chart



Source: Company, Axis Securities

Key Risks & Concerns

- ♦ **Regional concentration:** While asset quality risks have been low, a sudden shock in any of the southern states, especially TN could result in an increase in GNPA's. Further, dominant southern focus limits growth opportunities as well.
- ♦ **Asset quality deterioration:** CUBK has managed its asset quality quite well given the stress faced by the other such banks. However, any deterioration in the asset quality may affect profitability of the company going forward.

Financials

Income Statement

(Rs mn)

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Interest Earned	31,738	34,024	39,084	47,019	56,970
Interest Expended	19,750	19,721	22,898	27,997	34,925
Net Interest Income	11,988	14,303	16,186	19,022	22,045
Other Income	4,839	5,321	5,197	5,430	5,778
Fee Income (CEB)	439	495	567	656	791
Treasury Income	1,078	938	1,200	975	825
Total Income	16,827	19,624	21,383	24,452	27,823
Total Operating Exp	6,890	7,546	8,453	9,530	10,812
Employee Expense	2,981	3,159	3,617	3,973	4,469
PPOP	9,937	12,078	12,930	14,922	17,011
Provisions & Contingencies	3,010	4,178	3,754	3,813	4,083
Prov. for NPAs (incl. stand. prov)	2,595	3,180	3,754	3,813	4,083
PBT	6,928	7,900	9,176	11,109	12,928
Provision for Tax	1,900	1,980	2,327	2,984	3,402
PAT	5,028	5,920	6,848	8,125	9,526

Source: Company, Axis Securities

Balance Sheet

(Rs mn)

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Sources of Funds					
Share Capital	601	665	732	732	732
Reserves	35,101	40,968	47,570	55,404	64,588
Shareholder's Funds	35,702	41,632	48,302	56,135	65,320
Savings	46,297	51,705	61,615	72,990	86,024
Current	24,092	27,862	25,602	28,536	31,644
Term Deposit	230,768	248,959	307,364	370,286	452,548
Total Deposits	301,157	328,526	394,581	471,812	570,216
Borrowings	5,310	17,359	9,704	13,817	17,193
Other Liabilities & Provisions	10,538	11,855	13,814	15,844	18,259
Total Liabilities	352,708	399,372	466,401	557,608	670,989
Application of Funds					
Cash & Bank Balance	28,790	26,364	29,343	35,343	41,448
Investments	70,315	78,791	87,527	104,401	125,854
G-Secs	66,906	76,344	84,835	101,440	122,597
Advances	238,327	278,528	331,448	397,738	481,263
Fixed Assets	2,151	2,231	2,343	2,460	2,583
Other Assets	13,126	13,458	15,740	17,666	19,841
Total Assets	352,708	399,372	466,401	557,608	670,989

Financials

Key Metrics (%)

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Valuation Ratios					
EPS	8.4	8.9	9.4	11.1	13.0
Earnings Growth (%)	13.1	17.7	15.7	18.6	17.2
BVPS	59.4	62.6	66	76.7	89.2
Adj. BVPS	52.6	55.4	58.9	68.0	80.0
ROAA (%)	1.5	1.6	1.6	1.6	1.6
ROAE (%)	15.2	15.3	15.2	15.6	15.6
P/E (x)	23.2	21.8	20.6	17.4	14.8
P/ABV (x)	3.7	3.5	3.3	2.8	2.4
P/PPOP (x)	11.7	10.7	10.9	9.5	8.3
Dividend Yield (%)	0.2	0.2	0.2	0.2	0.2
Profitability					
Yield on Advances (%)	11.5	11.0	10.9	11.0	11.1
Yield on Investment (%)	8.1	7.0	7.0	7.0	6.8
Cost of Funds (%)	6.8	6.0	6.1	6.3	6.51
Cost of Deposits (%)	6.8	6.1	6.2	6.3	7.0
Core Spread (%)	4.7	4.9	4.8	4.7	4.6
NIM (%)	3.9	4.2	4.0	4.0	3.8
Operating Efficiency					
Cost/Avg. Asset Ratio (%)	2.1	2	2	1.9	1.8
Cost-Income Ratio (%)	43.7	40.4	41.9	40.6	40.0

Source: Company, Axis Securities

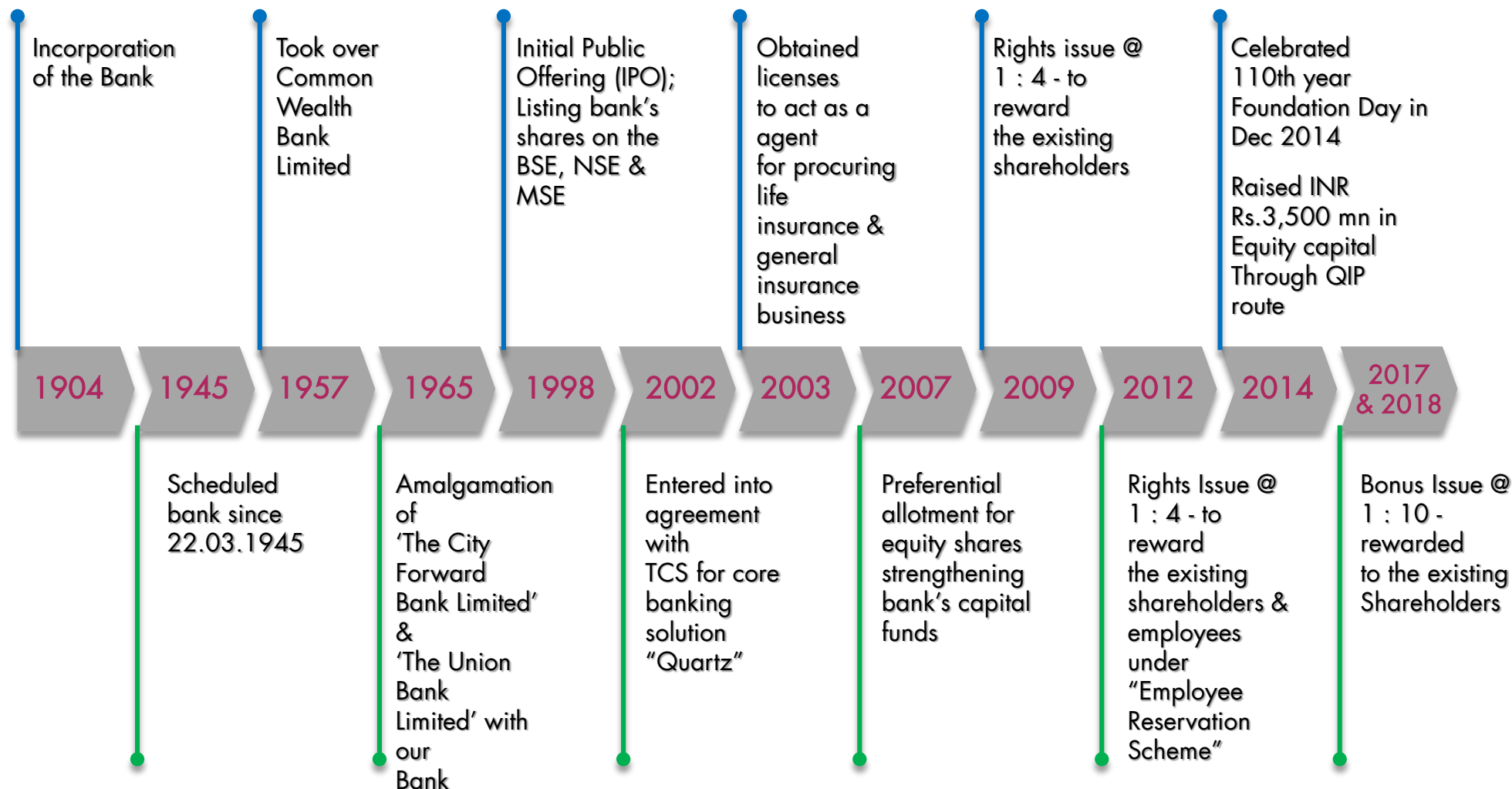
Key Metrics (%)

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Balance Sheet Structure Ratios					
Loan Growth (%)	13.2	16.9	19.0	20.0	21.0
Deposit Growth (%)	10.9	9.1	20.1	19.6	20.9
C/D Ratio (%)	79.1	84.8	84	84.3	84.4
Equity/Assets (%)	10.1	10.4	10.4	10.1	9.7
Equity/Loans (%)	15	14.9	14.6	14.1	13.6
CASA (%)	23.4	24.2	22.1	21.5	20.6
Total Capital Adequacy Ratio (CAR)	15.8	16.0	15.6	14.9	14.2
Tier I CAR	15.4	15.6	15.3	14.7	14.0
Asset Quality					
Gross NPLs (Rsm)	6,820	8,565	9,579	10,491	11,809
Net NPLs (Rsm)	4,083	4,793	5,196	6,390	7,496
Gross NPLs (%)	2.83	3.03	2.85	2.61	2.43
Net NPLs (%)	1.71	1.72	1.57	1.61	1.56
Coverage Ratio (%)	61.0	64.0	71.7	69.6	68.6
LLP (%)	1.12	1.17	1.19	1.00	0.89
ROAA Tree					
Net Interest Income	3.60%	3.80%	3.74%	3.72%	3.59%
Non Interest Income	1.45%	1.42%	1.20%	1.06%	0.94%
Treasury Income	0.32%	0.25%	0.28%	0.19%	0.13%
Operating Cost	2.07%	2.01%	1.95%	1.86%	1.76%
Provisions	0.90%	1.11%	0.87%	0.74%	0.66%
Provisions for NPAs	0.76%	0.81%	0.84%	0.72%	0.64%
Tax	0.57%	0.53%	0.54%	0.58%	0.55%
ROAA	1.51%	1.57%	1.58%	1.59%	1.55%
Leverage (x)	10.0	9.7	9.6	9.8	10.1
ROAE	15.2%	15.3%	15.2%	15.6%	15.7%

City Union Bank

Sector: BFSI

Key Milestones



Source: Company, Axis Securities

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