

22 October 2024

India | Equity Research | Q2FY25 results review

## City Union Bank

Banking

### Healthy business growth and strong RoA; aims for further improvement in net NPA / PCR

City Union Bank (CUBK) reported better than our expected set of results with Q2FY25 PAT of INR 2.85bn (9% beat; RoA of 1.59%) aided by improved asset/earnings quality. Despite fifth consecutive quarter of net slippages, provisions increased QoQ as the bank improved PCR (to 55%) and reduced net NPA to 1.62%. Loan growth accelerated further to ~12% YoY (up 5% QoQ) driven by traditional products. Despite the launch of new retail products being pushed-out to Q4FY25, management sounded confident on growth converging towards systemic growth by FY25. LDR, at 83%, is comfortable and CET 1 is strong at 21.98%; though reported LCR nosedived to 121% (vs. ~260% QoQ). We also like CUBK's stance of improving PCR and paring net NPA as the current stress formation seems negligible.

### Upgrade to BUY; TP revised to INR 190

Despite the Q2FY25 beat, our earnings estimates are broadly unchanged as we increase FY25/26 PCR to 62%/64% (vs. 56%/60% earlier). Our growth estimates are unchanged at 13%/15% YoY for FY25E/FY26E. We raise our target multiple to ~1.4x (vs. ~1.3x earlier), broadly in-line with forward RoA. On balance, we upgrade CUBK to BUY (from Add) with a revised target price of INR 190 (vs. INR 180). A key risk is lower loan growth impacting operating leverage. Our target multiple is at ~15% discount to that of KVB's, which we believe is justified due to the latter's better cost of deposits (CoD), superior NIM/RoA and better asset quality.

### Loan growth accelerates to 12% YoY (up 5% QoQ); retail product launch pushed out to Q4FY25

Loan growth accelerated further to 12% YoY (up 5% QoQ) vs. ~10% YoY in Q1FY25. Growth was led by traditional segments and further enabled by gold and NBFC segments. Gold loans (~25% of loans) reported ~8% QoQ growth and 14% YoY. NBFC loans (~3.5% of loans) also jumped by ~23% QoQ (up 47% YoY). The commercial launch of the new retail loans (home loans, LAP and micro-LAP) has been pushed out to Q4FY25. CUBK expects a slow and calibrated start and targets 2–3% share in overall loans by FY26, before rising to 7–8% in the next 2–3 years. The bank, without sharing quantitative guidance, sounded more confident on growth converging (or even coming in ahead) toward system levels by FY25. We keep our loan growth estimates unchanged at 13%/15% for FY25E/FY26E.

### Financial Summary

Y/E March	FY23A	FY24A	FY25E	FY26E
NII (INR bn)	21.6	21.2	23.1	25.6
Op. profit (INR bn)	18.2	15.2	16.0	17.8
Net Profit (INR bn)	9.4	10.2	10.6	11.8
EPS (INR)	12.7	13.7	14.3	16.0
EPS % change YoY	23.1	8.3	4.6	11.2
ABV (INR)	90.4	104.4	120.2	135.4
P/BV (x)	1.5	1.3	1.2	1.1
P/ABV (x)	1.7	1.4	1.3	1.1
Return on Assets (%)	1.5	1.5	1.4	1.4
Return on Equity (%)	13.4	12.8	12.0	11.9

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### Market Data

Market Cap (INR)	112bn
Market Cap (USD)	1,327mn
Bloomberg Code	CUBK IN
Reuters Code	CTBK.BO
52-week Range (INR)	176 /125
Free Float (%)	97.0
ADTV-3M (mn) (USD)	6.0

Price Performance (%)	3m	6m	12m
Absolute	(3.0)	(2.1)	10.7
Relative to Sensex	(3.6)	(13.2)	(13.4)

Earnings Revisions (%)	FY25E	FY26E
PAT	1	(2)

### Previous Reports

28-07-2024: [Q1FY25 results review](#)21-05-2024: [Q4FY24 results review](#)

### NIM uptick off low base; LCR drops sharply to 121%

CUBK's deposit growth witnessed a strong uptick, growing 5% QoQ (up ~9% YoY). Its CASA deposits grew 4% QoQ/8% YoY while the CASA ratio stayed flat QoQ at 29.5%.

Post a change in methodology, reported LCR nosedived to 121% vs. 262% QoQ. Borrowings have shrunk a significant 44% YoY, and 46% since Mar'24, possibly in the bank's bid to spur LCR. CUBK mentioned about focusing more on LCR-friendly measures such as non-callable deposits, going ahead. Separately, LDR was reasonably stable at 83%.

CoD was largely flat at 5.75% vs. 5.72% QoQ. However, yield on advances improved significantly by 22bps QoQ to 9.81%. Importantly, reported yields were depressed in Q1 due to penal interest getting clubbed under fee. The bank also mentioned healthy growth in gold loans (with better pass through) as an additional reason for uptick in yields.

Overall, NIM improved 13bps QoQ (off low base) to 3.67%. Management maintained NIM guidance of 3.6% (+/- 10bps). Around 50% of the overall loans are linked to EBLR, 30-35% are linked to MCLR and rest are fixed.

### Net slippages remain negative; aims for improvement in net NPA ratio to 1-1.2% by FY25 vs. 1.62% now

Gross slippages remained stable at INR 1.76bn while the slippage ratio declined to 1.47% vs 1.56% QoQ. Recoveries and upgrades were strong and outpaced slippages. Overall, net slippages remained negative for the fifth consecutive quarter. This, along with write-offs totalling ~INR 559mn, led to GNPA declining 4.5% QoQ. GNPA ratio improved sharply by 34bps QoQ to 3.54%.

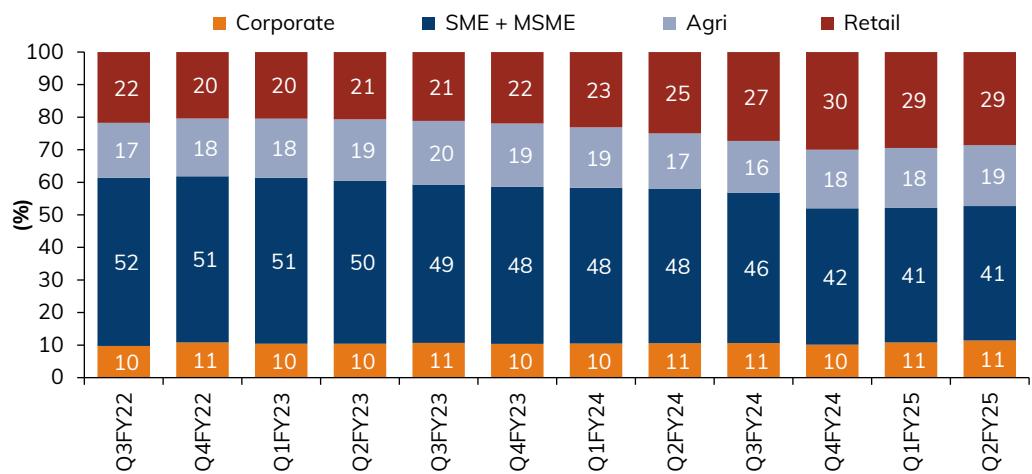
Despite negative slippages, CUBK hiked provisions with credit costs at ~60bps vs. 36bps QoQ. PCR increased over 200bps to 55% and net NPA improved 25bps QoQ to 1.62%. The bank acknowledges relatively lower specific PCR levels. It would look to improve PCR further and improve its net NPA ratio to 1-1.2% by FY25.

SMA 2 book remains comfortable at 2%. There was a rise in standard restructured loans, as there were some upgrades from NPA to RSA book.

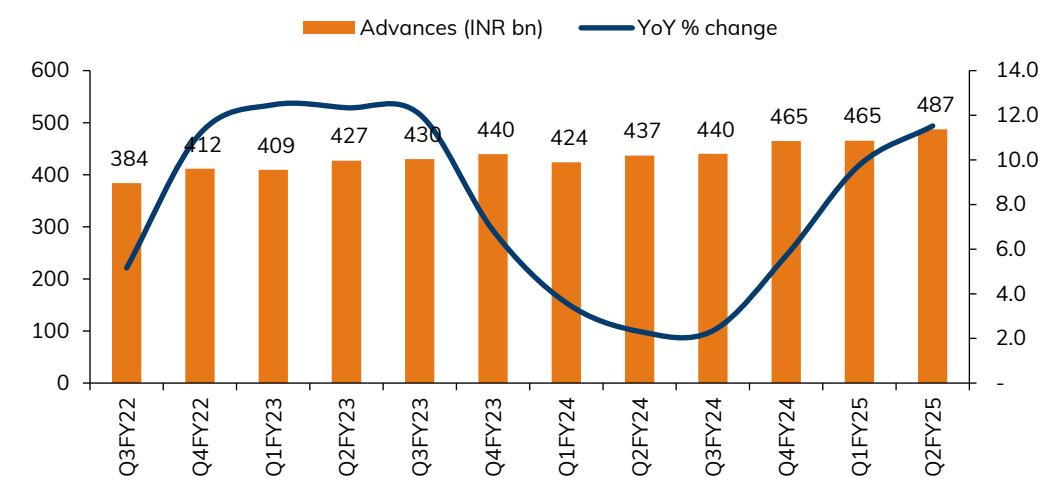
**Exhibit 1: Q2FY25 result review**

	Q2FY24	Q2FY25	YoY (%)	Q1FY25	QoQ (%)
<b>Financial Highlights (INR mn)</b>					
Interest Earned	13,040	14,339	10.0	13,886	3.3
Interest Expended	7,656	8,515	11.2	8,435	0.9
<b>Net Interest Income</b>	<b>5,384</b>	<b>5,825</b>	<b>8.2</b>	<b>5,452</b>	<b>6.8</b>
Other Income	1,821	2,263	24.3	1,921	17.8
Total Income	14,861	16,603	11.7	15,808	5.0
<b>Total Net Income</b>	<b>7,205</b>	<b>8,088</b>	<b>12.3</b>	<b>7,373</b>	<b>9.7</b>
Staff Expenses	1,582	1,835	16.0	1,744	5.2
Other operating expenses	1,757	1,971	12.2	1,894	4.1
<b>Operating Profit</b>	<b>3,866</b>	<b>4,282</b>	<b>10.8</b>	<b>3,735</b>	<b>14.6</b>
Provision & Contingencies	560	700	25.0	390	79.5
Provision for tax	500	730	46.0	700	4.3
<b>Reported Profit</b>	<b>2,806</b>	<b>2,852</b>	<b>1.6</b>	<b>2,645</b>	<b>7.8</b>
<b>Other Highlights (INR bn)</b>					
Advances	427	478	12.0	456	4.7
Deposits	527	574	8.8	549	4.6
Gross NPA INR bn	20.3	17.3	-15.2	18.1	-4.5
Gross NPA (%)	4.66	3.54	-112 bps	3.88	-34 bps
Net NPA INR bn	10.0	7.8	-22.4	8.5	-9.2
Net NPA (%)	2.34	1.62	-72 bps	1.87	-25 bps
Provision Coverage (%)	50.9	55.1	417 bps	52.8	233 bps

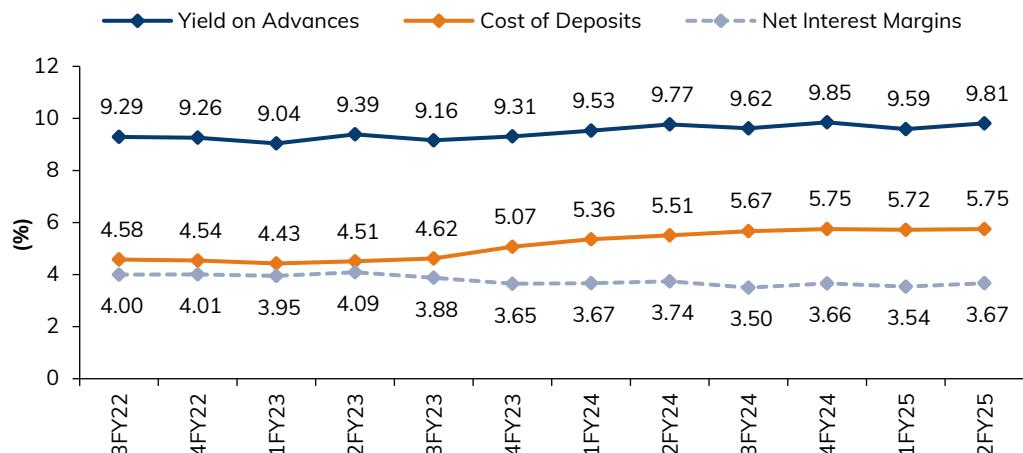
Source: Company data, I-Sec research

**Exhibit 2: Broadly stable loan mix**


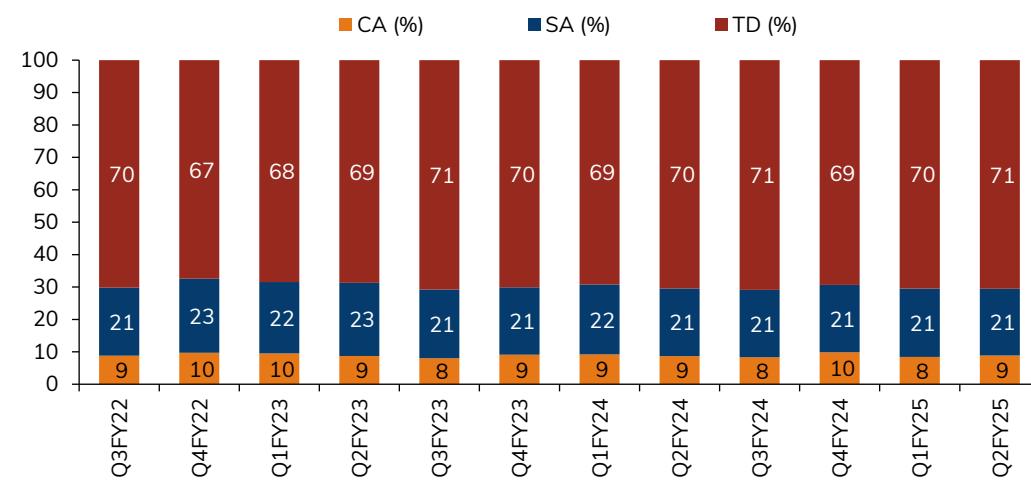
Source: Company data, I-Sec research

**Exhibit 3: Advances growth accelerates YoY**


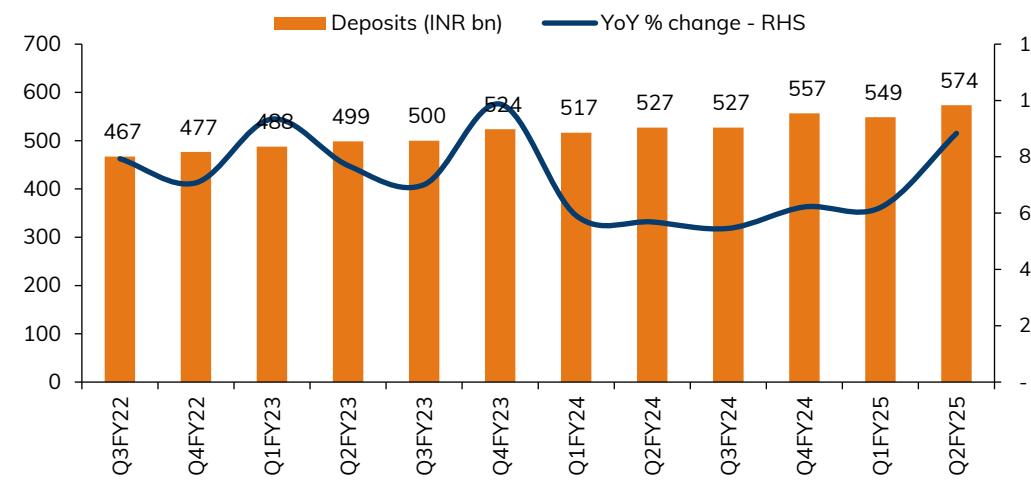
Source: Company data, I-Sec research

**Exhibit 4: NIM improves as yields increase QoQ**


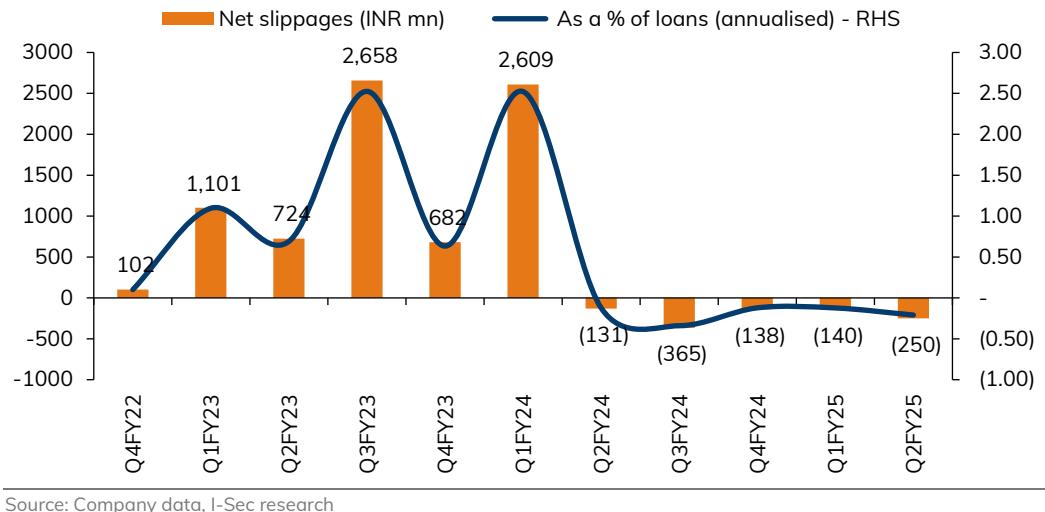
Source: Company data, I-Sec research

**Exhibit 5: Deposit mix broadly stable over the quarters**


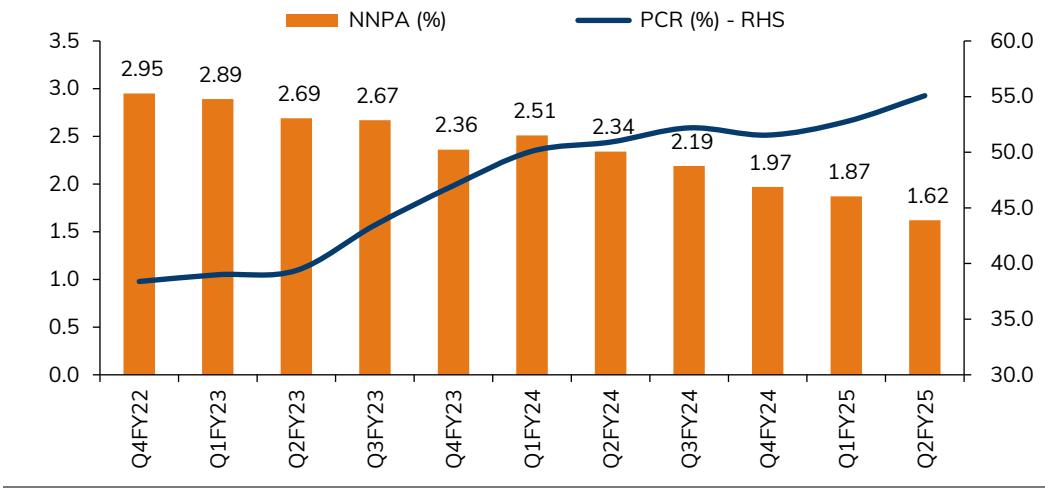
Source: Company data, I-Sec research

**Exhibit 6: Deposit growth improves to 9% YoY**


Source: Company data, I-Sec research

**Exhibit 7: Net slippages remain negative for fifth consecutive quarter**


Source: Company data, I-Sec research

**Exhibit 8: NNPA ratio trending lower**


Source: Company data, I-Sec research

**Exhibit 9: Key ratios and trends**

	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
<b>Loans INR mn</b>	<b>4,19,130</b>	<b>4,21,151</b>	<b>4,30,533</b>	<b>4,13,782</b>	<b>4,26,522</b>	<b>4,29,637</b>	<b>4,55,257</b>	<b>4,56,415</b>	<b>4,77,715</b>
<b>Loans YoY</b>	<b>12.9</b>	<b>11.8</b>	<b>6.7</b>	<b>3.0</b>	<b>1.8</b>	<b>2.0</b>	<b>5.7</b>	<b>10.3</b>	<b>12.0</b>
CASA %	31.3	29.2	29.9	30.8	29.6	29.1	30.6	29.5	29.4
NIM %	4.09	3.88	3.65	3.67	3.74	3.50	3.66	3.54	3.67
Slippages (INR mn)	2,615	4,391	3,582	3,822	2,247	1,872	2,194	1,783	1,760
Slippages %	2.8	4.7	3.6	3.8	2.1	1.8	2.0	1.7	1.7
Restructured (O/s) %	4.7	4.1	2.9	2.8	2.6	2.4	2.0	1.8	1.8
Tier I %	19.0	19.4	21.3	22.0	22.2	20.8	22.8	22.6	22.0
<b>RoE Decomposition</b>									
NII	<b>3.6</b>	<b>3.4</b>	<b>3.1</b>	<b>3.2</b>	<b>3.3</b>	<b>3.1</b>	<b>3.2</b>	<b>3.1</b>	<b>3.3</b>
Other Income	0.8	1.2	1.1	0.9	0.9	1.0	0.8	1.0	1.1
Opex	1.8	1.8	1.8	1.8	2.0	2.0	2.1	2.1	2.2
PPOP	<b>2.9</b>	<b>3.1</b>	<b>2.5</b>	<b>2.5</b>	<b>2.3</b>	<b>2.2</b>	<b>2.0</b>	<b>2.1</b>	<b>2.4</b>
Provisioning Cost	0.7	1.4	1.0	0.9	0.3	0.3	0.2	0.2	0.4
<b>PBT</b>	<b>2.2</b>	<b>1.7</b>	<b>1.6</b>	<b>1.6</b>	<b>2.0</b>	<b>1.9</b>	<b>1.9</b>	<b>1.9</b>	<b>2.0</b>
<b>ROA</b>	<b>1.7</b>	<b>1.3</b>	<b>1.3</b>	<b>1.4</b>	<b>1.7</b>	<b>1.5</b>	<b>1.5</b>	<b>1.5</b>	<b>1.6</b>
<b>ROE</b>	<b>16.0</b>	<b>12.2</b>	<b>11.9</b>	<b>12.0</b>	<b>14.4</b>	<b>12.6</b>	<b>12.3</b>	<b>12.3</b>	<b>12.9</b>

Source: Company data, I-Sec research

## Q2FY25 earnings call highlights

### Guidance

- No guidance on loan growth, though the bank cites improved visibility on loan growth. It would aspire to reach industry level (or slightly ahead) growth by FY25 and thereafter.
- After multi-quarters of negative operating profit growth, has entered into strong growth YoY.
- NIM, RoA and cost income are likely to remain broadly stable.
- NIM guidance retained at 3.6%, +/-10bps.
- The bank would like to improve its PCR and pare net NPA to 1-1.25% by FY25.

### Asset quality

- The bank maintains its guidance of INR 8bn worth of slippages for FY25.
- It will explore possibilities of increasing PCR this year, as it is a slight outlier in this aspect. It targets net NPA ratio to improve to 1-1.25% range by FY25.
- Recovery environment still healthy and bank expect steady recoveries.
- SMA book is at 2%

### Business growth

- CY23 was weak due to multiple reasons, including drag on KCC loans. Growth improved to 12% YoY/5% QoQ – driven by traditional products and segments.
- Growth has come from gold loans, NBFC and core segments.
- New retail products are yet to contribute meaningfully. Q4FY25 would likely see the commercial soft launch of these products. The bank aims to start with secured products first.
- There is healthy growth in gold loans. There is also healthy demand in the underlying segment, but the bank would like to focus on gold loans. It also wants to ramp up fixed rate loans, as the rate cut cycle is approaching. Any incremental advance in gold loans is now fixed rate. ~25-30% of its gold loans book is already converted to fixed rate and the bank hopes to increase it to 50% when the rate cut cycle starts.

### New retail products

- Current status of new products: Technology is ready, senior management team is in place. Hiring of field staff and preparing SoPs is a work in progress.
- Q4FY25 would see the commercial soft launch of these products. The bank would start from secured products first. Significant contribution from new products will likely start coming in from FY26.
- ETB customers have taken ~INR 70-80bn worth of loans in these products from competitors, as the bank did not offer them. It endeavours to deepen existing relationships initially.
- Bank also aims to target NTB customers for retail products. Sourcing will be done by branches and feet on street in south India, whereas it will be done by third party/DSA channel in northern and western India. In-house sourcing will likely have negligible costs while third party sourcing shall have some opex.
- The bank targets 2-3% share of new products in FY26 and plans to increase it to 7-8% in the next 2-3 years.

- In the first year, the bank expects to lose money, while the second year will potentially see breakeven; the third year shall be RoA accretive.

### Opex

- CI declined from 49.3% to 47.1% QoQ.
- Loan processing charges improved sharply from INR 230mn to INR 380mn, which aided in reduction of CI ratio.
- CI should be between 48–50% for the year and may gradually decline thereon. CI is expected to remain elevated during the year, as the bank is investing in new products.

### NIM and LCR

- Post change in methodology, LCR has come down to 121% (vs. 260% reported in Q1). The bank would try to focus more on LCR-friendly measures such as non-callable deposits, etc.
- NIM came in at 3.67% vs. 3.54% QoQ.
- NIM guidance retained at 3.6%, +/-10bps.
- Yield on gold loans were revised upward in the last 3–4 months, which helped overall yields. The bank was unable to pass on the repo increase last year, which is happening now upon renewals. This is expected to continue till the rate cut cycle starts.
- Loan book breakup: 50% - EBLR linked, 30–35% - MCLR linked, balance is fixed rate.
- NII got a bump from interest on IT refund – was INR 90mn in H1FY24 and jumped to INR 400mn in H1FY25.
- There is healthy growth contribution to lending to NBFC. However, there is little difference in the segment yields and overall.

**Exhibit 10: Shareholding pattern**

%	Mar'24	Jun'24	Sep'24
Promoters	0.0	0.0	0.0
Institutional investors	56.5	57.6	59.6
MFs and others	24.5	27.0	29.5
FIIs/Banks	0.1	0.5	0.6
Insurance	3.2	3.7	3.5
FIIs	28.6	26.4	26.0
Others	43.5	42.4	40.4

Source: Bloomberg

**Exhibit 11: Price chart**



Source: Bloomberg

## Financial Summary

### Exhibit 12: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest income	47,143	52,706	58,020	64,352
Interest expense	25,515	31,471	34,943	38,725
<b>Net interest income</b>	<b>21,628</b>	<b>21,235</b>	<b>23,077</b>	<b>25,627</b>
Non-interest income	8,104	7,417	8,735	10,012
<b>Operating income</b>	<b>29,732</b>	<b>28,651</b>	<b>31,813</b>	<b>35,639</b>
Operating expense	11,552	13,484	15,792	17,868
Staff expense	5,304	6,138	7,375	8,466
<b>Operating profit</b>	<b>18,180</b>	<b>15,167</b>	<b>16,020</b>	<b>17,770</b>
<b>Core operating profit</b>	<b>18,458</b>	<b>14,651</b>	<b>15,220</b>	<b>16,870</b>
Provisions & Contingencies	6,405	2,860	2,739	2,996
<b>Pre-tax profit</b>	<b>11,775</b>	<b>12,307</b>	<b>13,282</b>	<b>14,774</b>
Tax (current + deferred)	2,400	2,150	2,656	2,955
<b>Net Profit</b>	<b>9,375</b>	<b>10,157</b>	<b>10,625</b>	<b>11,819</b>
<b>Adjusted net profit</b>	<b>9,375</b>	<b>10,157</b>	<b>10,625</b>	<b>11,819</b>

Source Company data, I-Sec research

### Exhibit 13: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Cash and balance with RBI/Banks	66,493	69,435	72,037	74,126
Investments	1,43,326	1,56,641	1,55,416	1,68,344
Advances	4,30,533	4,55,257	5,14,983	5,94,270
Fixed assets	2,393	2,704	2,953	3,369
Other assets	23,200	24,221	28,564	33,883
<b>Total assets</b>	<b>6,65,946</b>	<b>7,08,259</b>	<b>7,73,953</b>	<b>8,73,992</b>
Deposits	5,23,979	5,56,566	6,19,494	7,04,099
Borrowings	46,881	47,242	35,388	37,158
Other liabilities and provisions	20,514	20,436	25,358	28,313
Share capital	740	741	741	741
Reserve & surplus	73,832	83,274	92,973	1,03,681
<b>Total equity &amp; liabilities</b>	<b>6,65,946</b>	<b>7,08,259</b>	<b>7,73,953</b>	<b>8,73,992</b>
% Growth	8.2	6.4	9.3	12.9

Source Company data, I-Sec research

### Exhibit 14: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
<b>No. of shares and per share data</b>				
No. of shares (mn)	740	741	741	741
Adjusted EPS	12.7	13.7	14.3	16.0
Book Value per share	101	113	127	141
Adjusted BVPS	90	104	120	135
<b>Valuation ratio</b>				
PER (x)	11.9	11.0	10.5	9.4
Price/ Book (x)	1.5	1.3	1.2	1.1
Price/ Adjusted book (x)	1.7	1.4	1.3	1.1
Dividend Yield (%)	0.7	1.0	0.8	1.0
<b>Profitability ratios (%)</b>				
Yield on advances	9.1	9.4	9.5	9.4
Yields on Assets	7.4	7.7	7.8	7.8
Cost of deposits	4.6	5.4	5.5	5.4
Cost of funds	4.0	4.6	4.7	4.7
NIMs	3.6	3.3	3.3	3.3
Cost/Income	38.9	47.1	49.6	50.1
<b>Dupont Analysis (as % of Avg Assets)</b>				
Interest Income	7.4	7.7	7.8	7.8
Interest expended	4.0	4.6	4.7	4.7
<b>Net Interest Income</b>	<b>3.4</b>	<b>3.1</b>	<b>3.1</b>	<b>3.1</b>
Non-interest income	1.3	1.1	1.2	1.2
Trading gains	0.0	0.1	0.1	0.1
Fee income	1.3	1.0	1.1	1.1
<b>Total Income</b>	<b>4.6</b>	<b>4.2</b>	<b>4.3</b>	<b>4.3</b>
<b>Total Cost</b>	<b>1.8</b>	<b>2.0</b>	<b>2.1</b>	<b>2.2</b>
Staff costs	0.8	0.9	1.0	1.0
Non-staff costs	1.0	1.1	1.1	1.1
<b>Operating Profit</b>	<b>2.8</b>	<b>2.2</b>	<b>2.2</b>	<b>2.2</b>
Core Operating Profit	2.9	2.1	2.1	2.0
Non-tax Provisions	1.0	0.4	0.4	0.4
<b>PBT</b>	<b>1.8</b>	<b>1.8</b>	<b>1.8</b>	<b>1.8</b>
Tax Provisions	0.4	0.3	0.4	0.4
<b>Return on Assets (%)</b>	<b>1.5</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>
Leverage (x)	9.1	8.7	8.3	8.3
<b>Return on Equity (%)</b>	<b>13.4</b>	<b>12.8</b>	<b>12.0</b>	<b>11.9</b>
<b>Asset quality ratios (%)</b>				
Gross NPA	4.4	4.0	3.1	2.5
Net NPA	2.4	2.0	1.2	0.9
PCR	47.0	51.5	62.0	64.0
Gross Slippages	3.3	2.4	1.8	1.9
LLP / Avg loans	1.7	0.7	0.7	0.7
Total provisions / Avg loans	1.5	0.6	0.6	0.5
Net NPA / Networth	13.6	10.7	6.7	5.3
<b>Capitalisation ratios (%)</b>				
Core Equity Tier 1	21.3	22.7	22.1	20.7
Tier 1 cap. adequacy	21.3	22.7	22.1	20.7
Total cap. adequacy	22.3	23.7	23.0	21.5

Source Company data, I-Sec research

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