

CMP: ₹ 147

Target: ₹ 160 (9%)

Target Period: 12 months

February 13, 2023

**HOLD**

## Divergence impacts quarter; growth outlook unclear

**About the stock:** City Union Bank is an old private sector bank with focus on MSME and agri loans that form 63% of overall advances.

- Strong presence in south India with 669 out of total 752 branches
- Total 99% of bank's advances are secured in nature

**Q3FY23 Results:** Decline in NIMs and higher provisions impacted earnings.

- Advances grew 12% YoY to ₹ 43009 crore. Deposits up 7% YoY with CASA growth at 5% YoY
- NII up 13.4% YoY (declined 2.1% QoQ). NIMs declined 21 bps QoQ at 3.88%
- GNPA up 26 bps QoQ to 4.62%. Restructured book declined to ~4%

**What should investors do?** One-off and divergence related provisioning impacted Q3FY23 earnings. Lack of clarity on business growth, anticipation of higher provision to improve coverage and higher focus on RoA is likely to impact valuation.

- Thus, we downgrade our rating on the stock from BUY to **HOLD**

**Target Price and Valuation:** Rolling to FY25E, we value City Union Bank at ~1.4x FY25E ABV and revise our target price from ₹ 215 to ₹ 160 per share.

### Key triggers for future price performance:

- Moderation in credit growth in the current scenario remains a surprise. The management is confident of achieving double digit growth in FY24E and maintained long term RoA guidance of 1.5%
- Relatively larger pool of stressed assets (~8.6% of advances) and potential impact in case of shift to ECL provisioning (estimated at ~₹ 200 crore to be divided in five years) could impact earnings trajectory
- Asset quality witnessed improvement but remained slower on a relative basis. Repayment from restructured book needs to be watched

**Alternate Stock Idea:** Apart from City Union Bank, in our coverage we also like CSB Bank.

- CSB Bank is a south based private sector bank with Kerala contributing ~30% of total business. Changed strategy in various aspects of lending has led to transformation and improved performance in the past few years
- BUY with a target price of ₹ 300

### Key Financial Summary

₹ crore	FY20	FY21	FY22	3 year CAGR (FY19-22)	FY23E	FY24E	FY25E	3 year CAGR (FY22-25E)
NII	1675	1830	1916	6%	2194	2470	2781	13%
PPP	1341	1468	1595	9%	1770	1984	2237	12%
PAT	533	593	760	2%	927	1042	1176	16%
BV (₹)	71.4	78.6	88.7		100.6	114.4	130.0	
ABV (₹)	60.8	64.1	74.0		87.0	100.7	116.3	
P/ABV	2.4	2.3	2.0		1.7	1.5	1.3	
P/BV	2.1	1.9	1.7		1.5	1.3	1.1	
P/E	20.3	18.3	14.3		11.7	10.4	9.2	
RoA	1.1	1.2	1.3		1.4	1.6	1.6	
RoE	10.7	10.6	12.2		13.2	14.0	13.9	

Source: Company, ICICI Direct Research



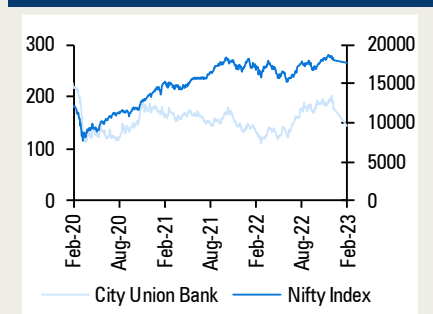
### Particulars

Particulars	Amount
Market Capitalisation	₹ 10613 crore
52 week H/L	204 /108
Networth	₹ 7193 crore
Face value	₹ 1

### Shareholding pattern

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	-	-	-	-	-
FII	16.0	18.1	18.2	21.3	23.8
DII	43.9	41.2	41.7	40.1	37.7
Others	40.1	40.7	40.2	38.5	38.5

### Price Chart



### Recent Event & Key risks

- GNPA up 26 bps QoQ to 4.62%. Restructured book at ~4%
- **Key Risk:** 1) Faster business growth to aid earnings; 2) Higher slippages may dent earnings

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## Key takeaways of recent quarter & conference call highlights

### Q3FY23 Results: Weak results; rise in provisions was linked to divergence

- NII growth was lower at 13.4% YoY (de-grew 2.1% QoQ) to ₹ 556 crore, largely due to a decline in NIMs (21 bps QoQ, 12 bps YoY). Other income was up 40.2% YoY, 29% QoQ mainly led by higher recoveries during the quarter
- Provisions jumped ~2x QoQ (1.8x YoY) at ₹ 225 crore. Rise in provisions was linked to divergence. Thus, PAT declined 21.2% QoQ (reported growth of 11.1% YoY) at ₹ 218 crore
- GNPA inched up 26 bps to 4.62% QoQ, led by divergence related slippage in Q3. Gross slippages were at ₹ 439 crore vs. ₹ 262 crore in Q2FY23
- Advances were up 12% YoY to ₹ 43009 crore, led by MSME and agri segment. On a sequential basis, advances growth was flat. Deposit growth was at 7% YoY to ₹ 49997 crore, CASA ratio was up 5% YoY. However, CASA ratio declined to 29.2% vs. 31.3% in Q2FY23 and 29.8% in Q3FY22

### Q3FY23 Earnings Conference Call highlights

- Credit growth to be marginally less than earlier guidance of 15-18% YoY for FY23. Slippages to be in the range of 2.5-2.8% for FY23 and should come down gradually in FY24E. CI to stay at ~40% levels. RoA target of 1.5% (ECL calculation should not impact RoA target)
- Interest income of ₹ 32 crore (from gold loans) was not recognised in Q3FY23 due to inadequate paperwork; the same should come in subsequent quarter. Average yield on gold loan is ~9%
- Except gold loan segment all other segments are on floating interest rate
- The divergence in additional GNPA was ₹ 259 crore. The bank held ₹ 742 crore specific NPA provision and as per RBI assessment provision requirement was ₹ 782 crore (divergence of ₹ 40 crore). The divergence in GNPA was not due to 90-day norm but due to various reasons including difference in interpretation of guidelines
- Out of total ₹ 439 crore slippages during Q3, ~₹140 crore was due to divergence
- Provision of ~₹ 25 crore in relation to exposure to SpiceJet written back in Q3FY23. Total ₹ 15 crore writeback is from standard assets
- SMA 2 book (including ECLGS) was at 2.19%. SR outstanding was ₹ 1.2 crore
- Total 70-75% of term deposits will be getting repriced in a year
- The bank opened 25 branches in Q3

### Exhibit 1: Peer Comparison (BFSI)

Sector / Company	CMP			M Cap (₹ Bn)	EPS (₹)				P/E (x)				P/ABV (x)				RoE (%)			
	(₹)	TP(₹)	Rating		FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
City Union (CITUNI)	147	160	Hold	106	8.0	10.3	12.5	14.1	18.3	14.3	11.7	10.4	2.3	2.0	1.7	1.5	10.6	12.2	13.2	14.0
Federal Bank (FEDBAN)	131	165	Buy	275	15.1	15.1	15.1	15.1	8.6	8.6	8.6	8.6	1.3	1.3	1.3	1.3	14.3	14.3	14.3	14.3
CSB Bank (CSBBAN)	239	300	Buy	41	12.6	26.4	30.2	33.2	19.0	9.0	7.9	7.2	2.2	1.7	1.4	1.2	10.5	19.0	18.0	16.8
IDFC First (IDFBAN)	58	70	Buy	359	0.8	0.2	3.4	4.7	72.3	246.1	17.1	12.3	2.1	1.9	1.6	1.5	2.7	0.8	9.5	12.0

Source: Company, ICICI Direct Research

Exhibit 2: Variance Analysis

	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
NII	556	490	13.4	568	-2.1	Decline in margin offset by credit growth
NIM (%)	3.88	4.00	-12 bps	4.09	-21 bps	
Other Income	224	160	40.2	173	29.3	Mainly led by higher recoveries
Net Total Income	780	650	20.0	741	5.2	
Staff cost	127	134	-5.2	141	-10.2	
Other Operating Expenses	156	147	6.4	144	8.5	
PPP	497	370	34.6	456	9.0	
Provision	225	124	81.8	105	113.8	Significant rise in provisions linked to divergence
PBT	273	246	10.9	351	-22.4	
Tax Outgo	55	50	10.0	75	-26.7	
PAT	218	196	11.1	276	-21.2	Higher credit cost impacts earnings trajectory
Key Metrics						
GNPA	1,989	1,999	-0.5	1,862	6.8	Restructured book at ~4% of total loans
NNPA	1,124	1,296	-13.2	1,129	-0.4	GNPA rose due to slippage from r/s book
Advances	43,009	38,387	12.0	42,702	0.7	
Deposits	49,997	46,722	7.0	49,878	0.2	

Source: Company, ICICI Direct Research

Exhibit 3: Assumption

(₹ Crore)	FY22E			FY23E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	1,902	1,916	1	2,183	2,194	1
Pre Provision Profit	1,523	1,595	5	1,745	1,770	1
NIM (%)	3.6	3.6	-7 bps	3.8	3.7	-14 bps
PAT	688	760	10	862	927	8
ABV (₹)	73.7	74.0	0.4	87.1	87.0	-0.2

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 4: Profit and loss statement					
	₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
Interest Earned	4,134.7	4,104.8	4,537.8	5,138.8	5,814.7
Interest Expended	2305.0	2188.3	2343.6	2668.6	3033.5
Net Interest Income	1,829.7	1,916.5	2,194.2	2,470.3	2,781.2
growth (%)	9.2	4.7	14.5	12.6	12.6
Non Interest Income	688.8	759.1	764.7	842.9	929.8
Net Income	2518.4	2675.6	2958.9	3313.2	3711.1
Staff cost	463.7	503.6	549.4	613.9	672.5
Other Operating expense	586.9	576.7	639.3	714.9	801.6
Operating profit	1467.8	1595.3	1770.2	1984.4	2237.0
Provisions	775.0	610.1	581.8	648.6	729.8
Taxes	100.0	225.0	261.5	293.9	331.6
Net Profit	592.8	760.2	927.0	1,042.0	1,175.6
growth (%)	11.2	28.2	21.9	12.4	12.8
EPS (₹)	8.0	10.3	12.5	14.1	15.9

Source: Company, ICICI Direct Research

Exhibit 5: Key Ratios					
(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
Valuation					
No. of Equity Shares	73.9	73.9	73.9	73.9	73.9
EPS (₹)	8.0	10.3	12.5	14.1	15.9
BV (₹)	78.6	88.7	100.6	114.4	130.0
ABV (₹)	64.1	74.0	87.0	100.7	116.3
P/E	18.3	14.3	11.7	10.4	9.2
P/BV	1.9	1.7	1.5	1.3	1.1
P/ABV	2.3	2.0	1.7	1.5	1.3
Yields & Margins (%)					
Net Interest Margins	3.7	3.6	3.7	3.7	3.7
Yield on assets	8.5	8.5	7.6	7.8	7.8
Avg. cost on funds	5.2	4.9	4.4	4.4	4.4
Yield on average advance	10.0	10.0	8.4	8.5	8.5
Avg. Cost of Deposits					
10/1	5.7	4.9	4.4	4.4	4.4
Cost to income ratio	41.3	40.4	40.1	40.0	39.6
Credit/Deposit ratio	81.2	84.6	85.7	86.8	87.9
GNPA	5.2	4.7	4.5	3.9	3.4
NNPA	3.0	3.0	2.2	1.9	1.7
ROE	10.6	12.2	13.2	14.0	13.9
ROA	1.2	1.3	1.4	1.6	1.6

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet					
	₹ crore				
(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
Sources of Funds					
Capital	73.9	74.0	74.0	74.0	74.0
Reserves and Surplus	5768.6	6511.7	7395.1	8413.7	9565.9
Networth	5842.5	6585.7	7469.0	8487.7	9639.9
Deposits	44537.4	47689.7	53429.3	60166.7	67758.3
Borrowings	1345.7	5311.8	3014.4	4069.4	5493.7
Other Liabilities & Provisic	1586.1	1943.7	1768.4	1869.9	1979.1
Total	53,312	61,531	65,681	74,594	84,871
Applications of Funds					
Fixed Assets	232.7	214.7	269.2	294.3	326.0
Investments	9435.9	12221.2	12563.8	13826.8	15217.1
Advances	36157.8	40358.5	45804.8	52217.5	59528.0
Other Assets	1870.2	2049.6	2120.7	3311.7	4661.5
Cash with RBI & call mor	5615.1	6686.9	4922.7	4943.3	5138.4
Total	53,312	61,531	65,681	74,594	84,871

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios					
(Year-end March)	FY21	FY22	FY23E	FY24E	FY25E
Total assets	7.2	15.4	6.7	13.6	13.8
Advances	6.6	11.6	13.5	14.0	14.0
Deposit	9.1	7.1	12.0	12.6	12.6
Total Income	-0.2	6.2	1.0	12.8	12.7
Net interest income	9.2	4.7	14.5	12.6	12.6
Operating expenses	3.6	2.8	10.0	11.8	10.9
Operating profit	9.4	8.7	11.0	12.1	12.7
Net profit	11.2	28.2	21.9	12.4	12.8
Net worth	10.4	12.7	13.5	13.7	13.6
EPS	8.0	10.3	12.5	14.1	15.9

Source: Company, ICICI Direct Research

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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