

City Union Bank Ltd.: Q1FY18 Result Update

CMP INR 160

Target INR 198

Extraordinarily low dependence on balance sheet growth for RoA delivery

Rating: BUY

Upside: 24%

City Union Bank (CUB) reported Q1FY18 results with quarterly PAT growing 14% yoy to INR 140 cr. While loan growth was moderate at 13% yoy, CUB continued to deliver best-in-class return ratios of 1.6% and 15.5% for Q1FY18 RoA and RoE, respectively, indicating particularly low dependence on balance sheet growth for return ratio delivery.

Return on Assets for the quarter remains a best-in-class 1.6% despite higher loan loss provisions

CUB Q1FY18 NII and Other Income each grew 22% yoy to INR 342 cr and INR 135 cr, respectively. Operating Expenses grew at a slower pace than Total Income at 16% yoy to INR 181 cr. Provisions (excluding Tax) grew much faster at 65% to INR 117 cr. Consequently, PAT grew 14% to INR 140 cr. Loan growth was 13% yoy with loan book growing to INR 24058 cr. While this was somewhat slower than prior full year FY18 guidance of 15-18%, this guidance remains intact, as per management. Importantly, and this has been the hallmark for CUB, despite the seemingly moderate balance sheet growth, CUB delivered best-in-class RoA of 1.6% for Q1FY18.

Outstanding Net Interest Margin (4.5%) and Cost to Income Ratio (38%) remain drivers of high return ratios

While Yield on Funds fell 29 bps yoy to 9.43% in Q1FY18, Cost of Funds fell more at 67 bps yoy to 5.52% resulting in a Net Interest Margin of 4.5% for the quarter. Net Interest Margin for FY17 had also been a best-in-class 4.2%. CUB possesses a sticky high-yielding MSME franchise that forms 51% of Q1FY18 loan book (including Retail Trade and Wholesale Trade). Furthermore, Cost to Income Ratio was a superior 38% for the quarter due to young workforce (average 27 years), Non-IBA bipartite employee settlement and migration of transactions to non-branch channels (c.80-85% by value). Furthermore, CUB remains one of the most well capitalised banks with a Tier 1 Ratio of 15.4%, implying its high return ratio delivery has been achieved even with a high capital base.

GNPA Ratio inches up to 3.05% but underlying asset quality remains sound

GNPA Ratio inched up to 3.05% at the end of Q1FY18 compared with 2.83% at the end of Q4FY17. This was primarily due to one relatively large steel account worth INR 93 cr slipping this quarter. However, the prior full year FY18 guidance for Gross Slippage Ratio remains intact at 1.75-2%. Management had earlier guided that Net Credit Costs for FY18 would be contained at 85-90 bps and would fall to 50-60 bps by FY19. Management reiterated that a reversion to earlier Net Credit Costs trend level of c.50 bps is 4-6 quarters away. Importantly, underlying asset quality remains sound with Restructured Standard Assets Ratio at 0.55% and Net Security Receipts at 1.1% of loan book. There is no exposure to 5/25, SDR and S4A forms of loan stress. Furthermore, Corporate Loans remain 7% of loan book and consortium loans at c.1% of loan book, indicating low macro risk from industrial capex issues.

Gold Loan book growth of 8% a good sign from an overall loan book growth perspective

Overall loan book growth of 13% yoy was somewhat slower than prior full year FY18 guidance of 15-18% due to somewhat tepid growth of 12% in MSME segment (34% of Q1FY18 loan book) and de-growth of -14% in Retail Trade (4% of loan book). Some of this could be attributed to onerous but transient GST compliance requirements. While Large Industries book grew faster at 26%, it still forms a relatively small 7% of overall loan book. Importantly, Gold Loan book (9% of loan book) grew 8% in a continued departure from the FY13-16 de-growth CAGR of -16% (FY17 growth stabilized at 4%). This book is no longer a significant drag on overall loan growth.

Valuation and Rating: Maintain 'BUY' with Price Target of INR 198

At the current price of INR 160, CUB trades at a P/B of 2.2x FY19E book. We have adjusted our numbers following the 1-for-10 bonus issue announced by CUB. We maintain 'BUY' Rating with an adjusted (unchanged from an economic perspective) Price Target of INR 198, at which the stock trades at 2.7x FY19 book.

(INR cr)	Q1FY18	Q1FY17	yoy%	Q4FY17	QoQ%
Net Interest Income	342	280	22%	311	10%
Other Income	135	111	22%	126	8%
Operating Expenses	181	155	16%	189	-4%
Pre Provisioning Operating Profit	297	236	26%	248	20%
Provisions excluding Tax	117	71	65%	71	64%
Profit after Tax	140	124	14%	129	9%

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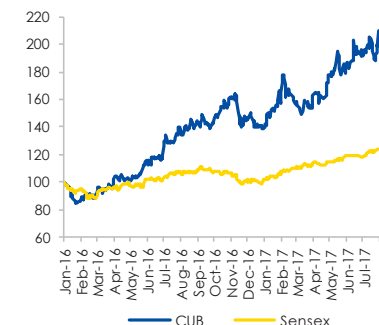
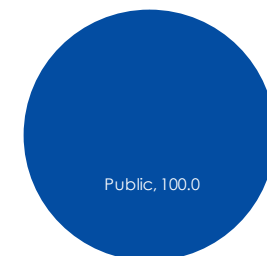
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Bloomberg:

CUB:IN

52-week range (INR):	186/ 114
Share in issue (cr):	67.8
M cap (INR cr):	11,111
Avg. Daily Vol. BSE/NSE	832
:(¹ 000):	

Share Holding Pattern (%)



Q1FY18 Result Highlights

P&L (INR cr)	Q1FY18	Q1FY17	YoY%	Q4FY17	QoQ%	FY18E	FY17	YoY%
Net Interest Income	342	280	22%	311	10%	1,452	1,199	21%
Other Income	135	111	22%	126	8%	542	484	12%
Total Income	478	391	22%	436	9%	1,994	1,683	19%
Operating Expenses	181	155	16%	189	-4%	795	689	15%
Pre Provisioning Operating Profit	297	236	26%	248	20%	1,200	994	21%
Provisions excluding Tax	117	71	65%	71	64%	336	301	12%
Profit before Tax	180	165	9%	176	2%	863	693	25%
Tax	40	42	-4%	48	-16%	224	190	18%
Profit after Tax	140	124	14%	129	9%	639	503	27%

Key Con Call Highlights

- The Watchlist equivalent of 3 major weak accounts of >INR 50 cr each saw one Steel account worth INR 93 slipping in Q1FY18.
- A Food Processing sector account from this Watchlist equivalent will slip in Q2FY18.
- The larger of the 2 remaining Watchlist accounts is worth INR 72 cr. (The total exposure to these 3 accounts was INR 243 cr as of Q4FY17).
- The Gross Slippage guidance of 1.75-2% for FY18 is inclusive of the above Watchlist equivalent.
- Gross Security Receipts book is INR 345 cr. Outstanding Provisions on this book is INR 73 cr. Incremental Provisions on this book in the rest of FY18 to be INR 50-60cr.
- Breakup of Non-Tax Provisions: Provisions for NPA – INR 86 cr, Investment Depreciation – INR 10 cr, Security Receipts – INR 23 cr.
- There was a Tax Refund of INR 11.3 cr in Q1FY18 that was included in the Other Income line.
- Exposure to the unorganised sector is about 5-8% of loan book. (The company is highly focused on formal documentation for credit appraisal.)
- About 90% of the loan book is now MCLR linked.

Financials

Income Statement (INR cr)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Interest income	2,944	3,174	3,604	4,232	5,067
Interest charges	1,963	1,975	2,151	2,531	3,058
Net interest income	981	1,199	1,452	1,701	2,008
Other income	410	484	542	608	702
Net revenues	1,391	1,683	1,994	2,309	2,710
Operating expense	558	689	795	929	1,056
- Employee exp	214	299	359	430	495
- Depreciation / amortisation	52	54	54	62	71
- Other opex	291	336	382	436	490
Preprovision op. profit	833	994	1,200	1,380	1,654
Provisions	231	301	336	370	408
PBT	603	693	863	1,010	1,246
Taxes	158	190	224	263	324
PAT	445	503	639	748	922
Reported PAT	445	503	639	748	922
Basic number of shares (cr.)	59.8	59.9	63.1	66.1	67.8
Basic EPS (INR)	7.44	8.39	10.12	11.31	13.60
Diluted number of shares (cr.)	61.2	61.0	64.3	67.4	69.1
Diluted EPS (INR)	7.27	8.24	9.93	11.09	13.35

Growth Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Nil growth	22%	22%	21%	17%	18%
Net Revenues growth	15%	21%	19%	16%	17%
Opex growth	7%	24%	15%	17%	14%
PPOP growth	20%	19%	21%	15%	20%
Provisions growth	26%	31%	12%	10%	10%
PAT growth	13%	13%	27%	17%	23%

Operating Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Yield on Average Advances and Investments	11.4%	10.7%	10.7%	10.8%	10.9%
Cost of Average Deposits and Borrowings	7.6%	6.8%	6.5%	6.7%	7.0%
Spread	3.7%	3.9%	4.2%	4.1%	4.0%
Net Interest Margin	3.8%	4.1%	4.4%	4.4%	4.4%
Cost to Income Ratio	40%	41%	40%	40%	39%
Tax Rate	26%	27%	26%	26%	26%

Balance Sheet (INR cr)

As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
CAPITAL AND LIABILITIES					
Share Capital	60	60	66	66	69
Reserves and Surplus	2,992	3,510	4,054	4,713	6,546
Deposits	27,158	30,116	34,550	40,212	46,567
Borrowings	113	531	531	531	531
Other Liabilities & Provisions	929	1,054	1,212	1,394	1,603
Total	31,252	35,271	40,413	46,915	55,316
ASSETS					
Cash and Balances with RBI	1,363	1,484	1,633	1,796	1,975
Balances with Banks & Call Money	1,238	1,395	1,534	1,688	1,856
Investments	6,324	7,031	7,693	8,420	9,220
Advances	21,057	23,833	27,884	33,740	40,488
Fixed Assets	218	215	247	284	327
Other Assets	1,053	1,313	1,422	988	1,449
Total	31,252	35,271	40,413	46,915	55,316

RoAE Decomposition

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income / Assets	3.3%	3.6%	3.8%	3.9%	3.9%
Other Income / Assets	1.4%	1.5%	1.4%	1.4%	1.4%
Net Revenues / Assets	4.7%	5.1%	5.3%	5.3%	5.3%
Operating Expense / Assets	1.9%	2.1%	2.1%	2.1%	2.1%
Provisions / Assets	0.8%	0.9%	0.9%	0.8%	0.8%
Taxes / Assets	0.5%	0.6%	0.6%	0.6%	0.6%
Total Costs / Assets	3.2%	3.5%	3.6%	3.6%	3.5%
Return on Assets	1.5%	1.5%	1.7%	1.7%	1.8%
Assets / Equity	10.3	10.0	9.8	9.8	9.0
Return on Average Equity	15.5%	15.2%	16.6%	16.8%	16.2%

Valuation Metrics

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Basic EPS	7.4	8.4	10.1	11.3	13.6
EPS growth	9%	13%	21%	12%	20%
Book value per share	51	59	62	72	95
Basic P/E	21.5	19.1	15.8	14.2	11.8
Price - to - Book	3.1	2.7	2.6	2.2	1.7

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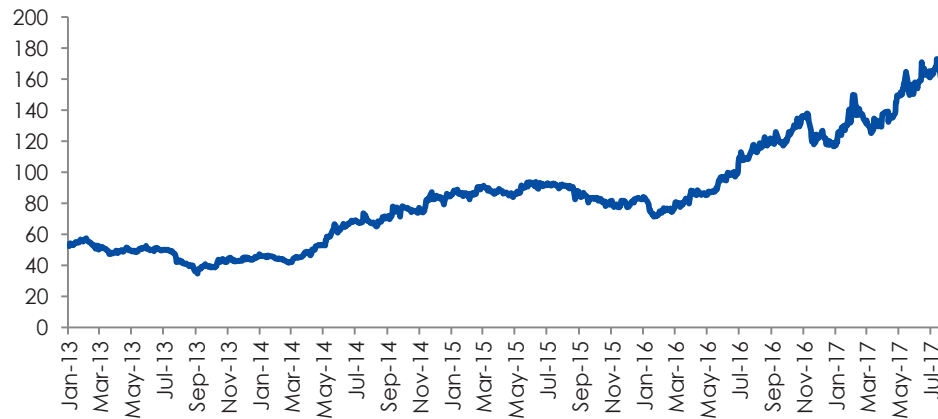
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Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period

City Union Bank Ltd 5 years price chart



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