

City Union Bank Ltd

INDUSTRY	BANKING
No. of Shares (Cr.)	40.82
Face value	Re.1.00
Mkt. Cap (Rs. Crore)	2077.74
Price (13/09/2012)	50.90
Book Value (Rs)	32.13
P/BV	1.58
BSE Code	532210
NSE Code	CUB
Bloomberg	CUBK IN
Reuters	CTBK.BO
Volume (Monthly) (NSE)	268510
52 W H/L (Rs.)(NSE)	58.50/39.10

Shareholding Pattern

	%
Promoters	-
MFs / Banks / FIs	7.32
Foreign	21.82
Non-Promoter Corp.	10.30
Total Public	50.88
Others	9.68
Total	100.00
(as on 30-June-2012)	

Recommendation

BUY



Company Background

City Union Bank (CUB) is a private sector bank with a legacy of over 100 years. Based out of Kumbakonam, Tamil Nadu, it has a network of 303 branches. The bank stands out from the rest due to its target SME customer profiling & loan product mix resulting in higher NIM and best in class returns matrix. While other banks build up scale through the wholesale business first and enter retail subsequently, CUB mainly lends to small businesses, traders, etc.

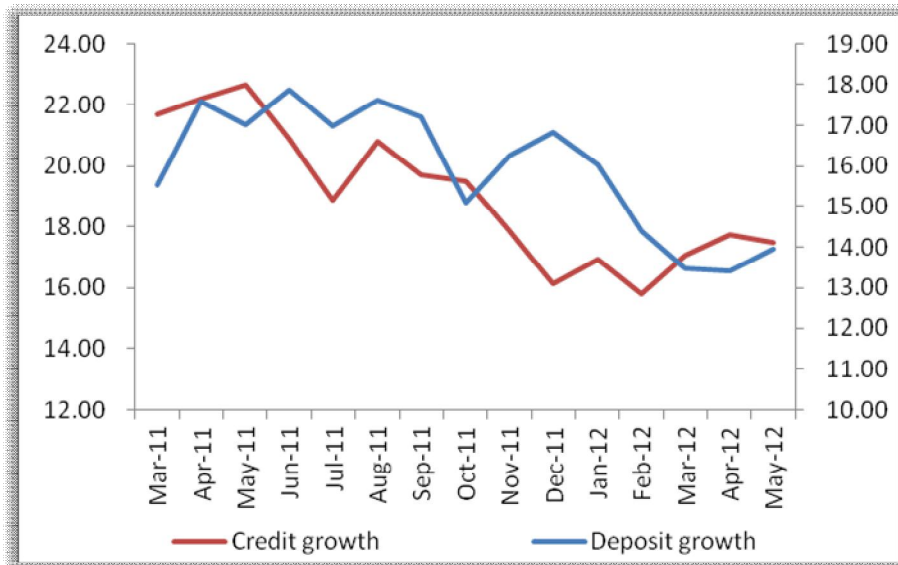
Highlights

- ❖ City Union Bank has been steadily expanding its business over the years. In the last five years, the bank has registered a business growth of 28% CAGR. While the deposits have grown at a CAGR of 28%, the Advances have grown at a CAGR of 30% over the last five years. In Q1FY13, the total advances by the bank stood at Rs.12773 Cr, up 33% on YoY basis and the total deposits taken by the bank stood at Rs.17062 Cr, up 25% on YoY basis.
- ❖ CUB targets a pan-India presence by expanding its branch network to 500 from the present 303 branches in the next three years.
- ❖ The bank has an interesting loan product mix as 65% of its advances are high interest yielding short-term loans fulfilling working capital requirements. This helps in generating a faster loan book churn as the average maturity of working capital loans is 1.75-3 years. Approximately 80% of its loan book is on a floating basis, which allows frequent loan book re-pricing during rising interest rate scenario. This reduces interest rate risk, thus protecting its NIM.
- ❖ The investment portfolio of City Union Bank is very well balanced with the AFS portfolio forming only a very small portion of the overall investment portfolio (7% of the Total investment portfolio in Q1FY13). This insulates CUB from suffering high M2M losses.
- ❖ CUB has fared very well in terms of maintaining its Asset quality over the years. The Gross NPA% has decreased from 1.81 in FY08 to 1.01 in FY12. The net NPA% for the same period have declined from 0.98 to 0.44. In Q1FY13, the Gross NPA% and Net NPA% stood at 1.07% and 0.50% respectively.
- ❖ The bank has sequentially expanded its Return on Net worth from 19.90 in FY09 to 24.91 in FY12. Its asset Utilization has also been excellent over the years and improved sequentially from 1.50 in FY09 to 1.71 in FY12. In Q1FY13, the RoA & RoE stood at 1.57% and 23.09 respectively.
- ❖ In Q1FY13, the bank has registered a NII of Rs. 137.94 Cr, up 15% YoY and net profit of Rs.73.89 Cr, up 27% YoY.
- ❖ CUB could be a possible take-over candidate once the Banking Laws (Amendment) Bill is passed.
- ❖ At CMP of Rs.50.90, the stock trades at 1.10X FY14E BV & 5.20x FY14E EPS. **We recommend a "BUY" on the stock with a price target of Rs 69.00, assuming a P/B of 1.50X FY14E Book-Value & P/E of 7x FY14E earnings, an upside of 36%, over a period of 12 months.**

Particulars	Q1 FY13	Q1FY12	% VAR.	FY10	FY11	FY12	FY13E	FY14E
Net Interest Income	137.94	120.04	14.91	278.14	420.03	499.75	666.33	853.77
Net Profit	73.89	58.51	26.29	152.76	215.05	280.25	344.78	399.63
EPS	1.81	1.43	26.57	3.82	5.31	6.87	8.45	9.79
NIM (%)	3.18	3.59		3.15	3.64	3.40	3.33	3.40
Net-NPA (%)	0.50	0.51		0.58	0.52	0.44	0.46	0.39

Business Details

City Union Bank (CUB) is an old private sector bank with a legacy of over 100 years. Based out of Kumbakonam, Tamil Nadu, it has a network of 303 branches with 264 branches concentrated in Southern India. CUB has a history of 100 years of profits and dividend payouts. The bank, which is concentrated primarily in Tamil Nadu with 66% of its total branch network, derives more than 70% of its business from the state alone. The bank, which is 100% CBS based, offers diverse products and services catering primarily to SME, traders and retail customers. It has a bancassurance tie-up with LIC and National Insurance Company. CUB has entered in contract with Export Credit & Guarantee Corporation Ltd (ECGC) for marketing export credit insurance products through its branch network and has also obtained a license to function as a depository participant (DP) under National Securities Depository Ltd.

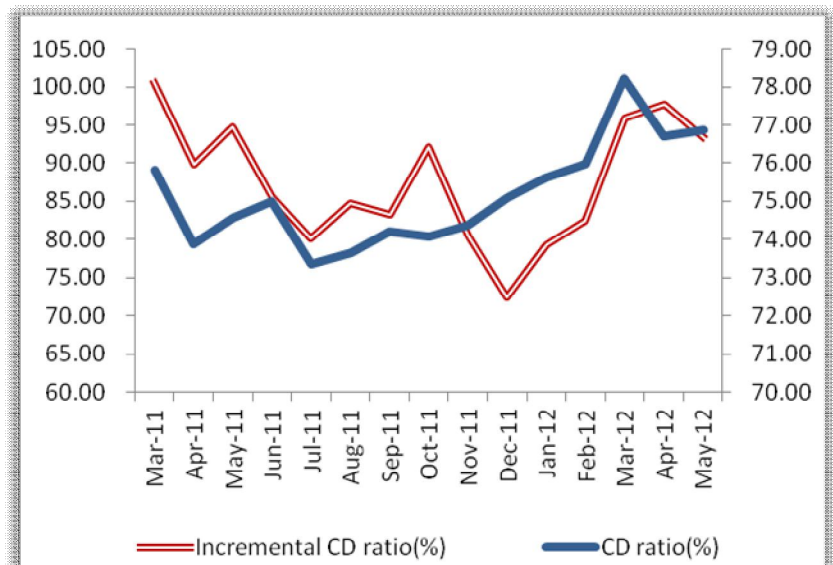


Industry Scenario

The Growth of the Indian Banking sector is directly linked with the growth of the Indian Economy. With the slowdown in the growth rate of the economy, there has been a decline in bank's credit creation in the recent times. A host of factors including slow reforms, weakening Indian Currency, widening Trade Deficit, Global Recessionary environment and above all rate tightening by the Central bank to arrest inflationary pressure has brought Industrial Activities to almost a halt. For the first two months of the current fiscal, the industrial growth is sharply lower at 0.8%, vs 5.7% in the year-ago period. This has in turn seriously affected the Indian Banking Sector as slower credit off-take; coupled with rising NPAs have impacted the overall performance of the sector. Banks' credit grew 1.2 percent in the first quarter of the fiscal

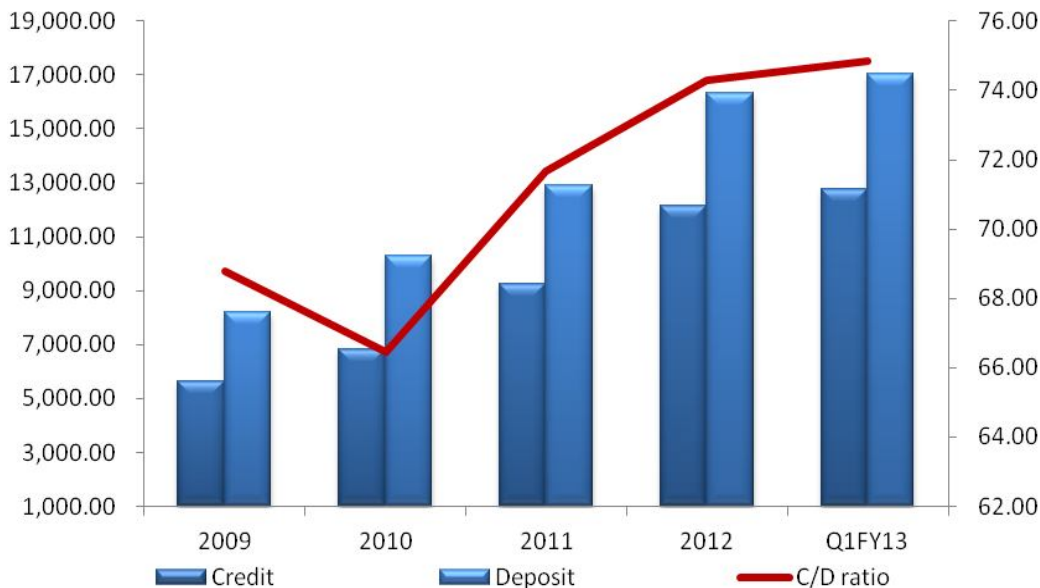
year that started in April, while deposits rose 1.9 percent. Presently, Banks' outstanding credit stands at 47,608.47 billion rupees and deposits stands at 62,291.73 billion rupees. The RBI has projected credit growth at 17 percent in FY13 and deposit growth at 16 percent. Banks' incremental credit-deposit ratio, which reflects fresh demand for loans in proportion to deposits, stood at just 48 percent compared with 51 percent in the same period last year and 84 percent in FY12. In the absence of demand for credit, banks continued to park their money in central and state government bonds. Investment in government bonds and other approved securities rose 6.7 percent to 18.6 trillion rupees in the three months to June.

However, the situation is not all that gloomy as it appears to be. The Government is increasing investment in agriculture and rural development, expanding financial inclusion and pushing for investment in manufacturing and infrastructure, which will translate into growth opportunities for several sectors such as steel, cement, aluminum, etc. To boost growth, RBI is likely to cut rates further during FY'13, though the extent of rate cuts will be contingent on the inflation trajectory. All this will provide an opportunity for banks to increase fund and non-fund business in a wide range of areas. It is a high possibility that the GDP growth has bottomed out in Q4 FY'12 at 5.3%, and economic growth would now gain traction. **Reviving Economic growth, easing interest rates resulting in improving Credit availability is expected to result in a steady revival of the Banking sector in H2FY13.**



Investment Rationale

Steady Business growth



City Union Bank has been steadily expanding its business over the years. In the last five years, the bank has registered a business growth of 28% CAGR. While the deposits have grown at a CAGR of 28%, the Advances have grown at a CAGR of 30% over the last five years. In Q1FY13, the total advances by the bank stood at Rs.12773 Cr, up 33% on YoY basis and the total deposits taken by the bank stood at Rs.17062 Cr, up 25% on YoY basis. This is commendable considering the fact that the Credit off-take for most banks has been muted since the second half of the last fiscal. **We expect the bank to continue its strong business growth aided by revival in credit-off take on**

account of improving economic scenario and increasing penetration by the Bank resulting in a wider customer base.

Growing Distribution Network with focus on South India

State	No. of Branches	% of Business
Tamilnadu	200	71
Andhra pradesh	34	9
Karnataka	20	5
Maharashtra	16	8
Kerala	10	2
Gujarat	6	1
Others	17	4
Total	303	

City Union Bank is predominantly a south-India based bank. Presently, the bank has a total network of 303 branches in India, with 264 branches located in south India and 200 in Tamil-Nadu, only (deriving 71% of the total business of the bank). The small sized bank aims to strengthen its existing

concentration down South by opening up new branches across Tier I to Tier VI centers and targets a pan-India presence by expanding its branch network to 500 branches in the next three years.

High Proportion of short-term loans

Loan Book Composition	Amount (Rs. Cr)	% of Total Advances
ODCC & demand Loans	8062.40	63%
Term Loans	4425.50	35%
Bills Purchased & Bills Discounted	285.30	2%
Gross Loans	12773.20	

CUB has gained from its target customer profiling and loan product composition, which provides it with pricing power (the ability to charge a higher interest

rate). The bank's comparative advantage lies in its positioning as a niche lender to small businesses like the local money lender of old times. The bank has stuck to its old private sector roots capitalizing on its concentration in South India, understanding of the market dynamics and its target customer needs. It is adept at catering to the requirements of its target market of SME and traders, which

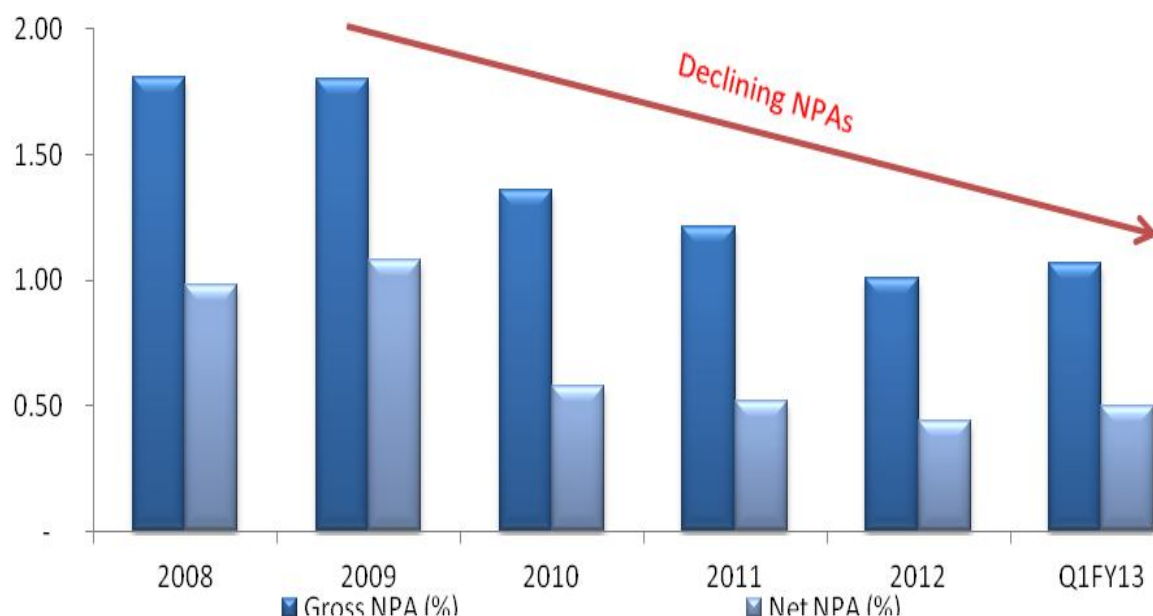
constitutes about 50% of its loan book, earning a higher rate of interest. The bank has an interesting loan product mix as 65% of its advances are high interest yielding short-term loans fulfilling working capital requirements. This also helps in generating a faster loan book churn as the average maturity of working capital loans is 1.75-3 years. Approximately 80% of its loan book is on a floating basis, which allows frequent loan book re-pricing during rising interest rate scenario. This reduces interest rate risk, thus protecting its NIM. Moreover, the bank keeps a very conservative risk-profile of its Loan portfolio as it has low average ticket size loans backed by collaterals. Unsecured loans for the bank amount to a mere 3% of total advances. **Focus on Higher yielding short-term loans and unique Credit portfolio Mix have enabled CUB to garner higher NIMS and steady credit growth even in the present challenging Macro-Environment.**

Low Proportion of AFS portfolio to reduce M2M losses

% of TOTAL INVESTMENT PORTFOLIO				
	FY10	FY11	FY12	Q1FY13
AFS	12	13	13	7
HTM	88	87	86	93
HFT		-	1	6
Duration				
AFS	2.89	2.98	3.19	1.96
HTM	5.98	5.65	5.16	5.18
HFT	-	-	4.52	-
Overall-portfolio	5.49	5.33	4.89	4.97

The investment portfolio of City Union Bank is very well balanced with the AFS portfolio forming only a very small portion of the overall investment portfolio (7% of the Total investment portfolio in Q1FY13). Historically, the bank has been maintaining very low proportion

of its total investment portfolio in AFS-category. This makes the bank less prone to mark to market losses. Also the overall duration of AFS portfolio is very short and hence the investment portfolio is relatively less prone to interest rate risks. **We expect a very efficient investment portfolio management from the bank in line with its past record, in the near future.**



Improving Asset Quality

CUB has been maintaining a sound asset quality despite growing its total business, so rapidly. In fact, in terms of NPA management it is one of the best banks in the whole banking space. It is CUB's lending philosophy, which helps rein in the asset quality as the bank mainly lends small ticket secured loans to SME and traders for wealth creation. Best practices of secured lending ensure paring of

losses in case of default as the bank maintains ~1:1 loan to collateral ratio. Moreover, a small ticket size mitigates concentration risk with no single large account turning into NPA.. The Gross NPA% has decreased from 1.81 in FY08 to 1.01 in FY12. The net NPA% for the same period have declined from 0.98 to 0.44. In Q1FY13, the Gross NPA% and Net NPA% stood at 1.07% and 0.50% respectively. The provision coverage ratio for the bank stood at 75% as on Q1FY13. This is well above the RBI's requirement of 70%. **We believe that the banks' effective monitoring of the stressed assets would ensure reduction in the gross NPA levels.**

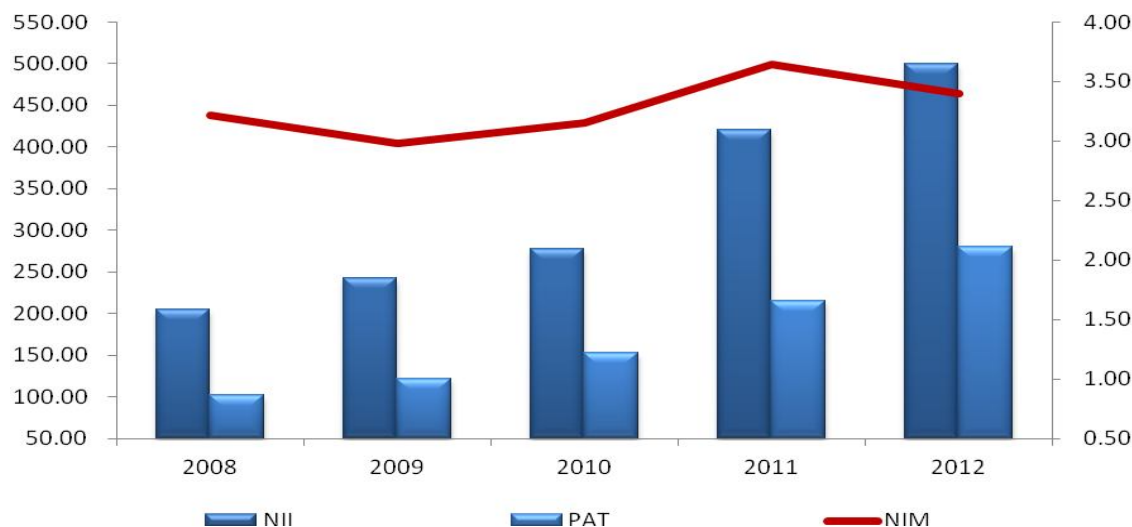
Possible Take-over Candidate

City Union Bank does not have any domestic or foreign promoters leading to speculation about a possible takeover of the smaller bank by one of the big players or new entrants as and when the Banking Laws (Amendment) Bill is passed. Although as per latest shareholding, ING Vysya Life Insurance Company Ltd which used to hold 1.3% has sold its entire stake, L&T finance Holdings and LIC still holds 4.7% and 4.25% respectively.

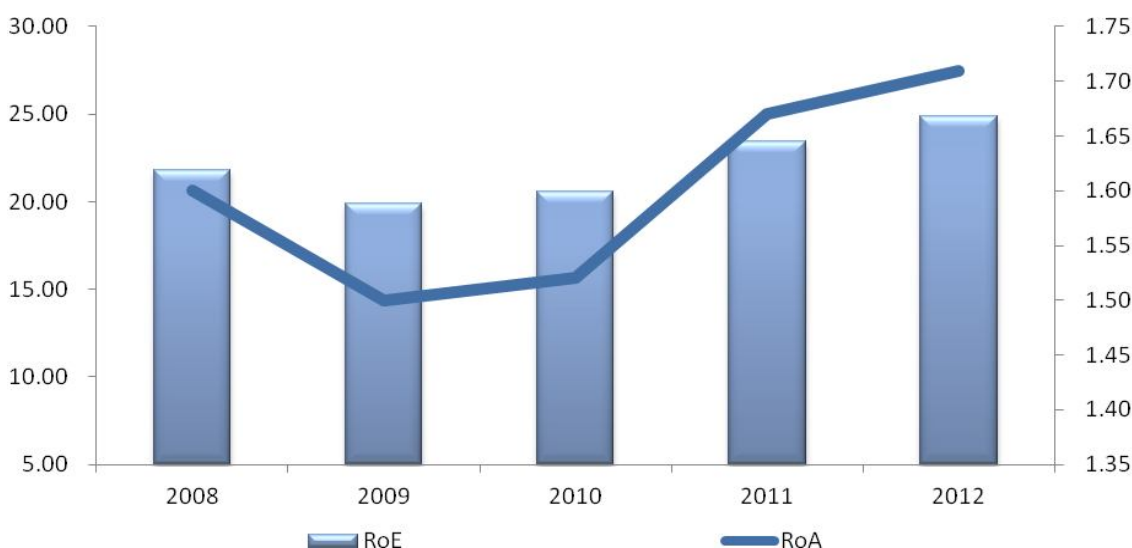
Capital Raising to fund future growth

CUB intends to raise Rs.350 Cr through the QIP route. This would augment its future capital needs. The bank is on track to achieve its Rs.3000 crore net worth to achieve growth of 25-27% till FY14E. The bank has already achieved a net worth of Rs.1000 crore in FY12. The Bank's Capital Adequacy ratio(CAR) stands at 12.01% in Q1FY13 and the fund raising by the bank would also help to improve its CAR, going forward.

Financial Performance



City Union Bank has done exceptionally well in terms of its financial performance. The growth in its net profit has been at a CAGR of 30% for the last five years and at a CAGR of 32% for the last three years. The performance has out-shined most of its peers, despite its small size and is clearly the testimony of the fact that it is on a high growth trajectory. In Q1FY13, the bank has registered a NII of Rs. 138 Cr, up 15% YoY and net profit of Rs.74 Cr, up 26% YoY. The NIM stood at 3.18% vs 3.59%, last Year.



The credit-deposit ratio for the bank has also been impressive over the years and presently stands at 74.86%.

CUB's unique business model is capable of sustaining higher returns (one of the best across industry) while achieving a larger scale of business. The bank's small size and niche positioning generates pricing power on the lending front leading to higher returns on its assets as well as equity employed. The bank has sequentially expanded its Return on Net worth from 19.90 in FY09 to 24.91 in FY12. Its asset

utilization has also been excellent over the years and improved sequentially from 1.50 in FY09 to 1.71 in FY12. In Q1FY13, the RoA & RoE stood at 1.57% and 23.09 respectively.

Consistent Dividend Payments

CUB has a very long history of consistent dividend payments. In FY12, the bank has declared a dividend of Re.1.00 per share (Face Value-Re.1.00).

Key Risks & Concerns

- ❖ Deterioration in the Global Economy affecting domestic economic growth.
- ❖ Resumption of up-trend in inflation resulting in further interest rate hikes.
- ❖ High Concentration Risk
- ❖ Over emphasis on MSME loans might lead to an upsurge in NPAs.
- ❖ Any adverse regulatory developments

Financials

QUARTERLY - RESULTS

Particulars	Q1FY13	Q1FY12	%chg
Interest Earned	504.21	371.14	35.85
Interest expended	366.27	251.10	45.87
NII	137.94	120.04	14.91
Other Income	62.69	45.88	36.64
Total Income	200.63	165.92	20.92
Operating Expenditure	86.48	59.56	45.20
Operating Income	114.15	106.36	7.32
Provisions & Contingencies	17.76	19.85	(10.53)
PBT	96.39	86.51	11.42
Tax	22.50	28.00	(19.64)
NET PROFIT	73.89	58.51	26.29
EPS	1.81	1.43	26.57

PROFIT & LOSS A/C

Particulars	2010	2011	2012	2013E	2014E
Interest Earned	956.61	1,218.41	1,696.77	2,224.80	2,831.73
Interest expended	678.47	798.38	1,197.02	1,558.48	1,977.96
NII	278.14	420.03	499.75	666.33	853.77
Other Income	143.50	157.40	207.13	261.60	283.96
Total Income	421.64	577.43	706.88	927.93	1,137.73
Operating Expenditure	165.85	216.40	279.83	383.78	494.14
Operating Income	255.79	361.03	427.05	544.15	643.59
Provisions & Contingencies	60.53	78.98	92.80	109.71	133.61
PBT	195.26	282.05	334.25	434.44	509.98
Tax	42.50	67.00	54.00	89.66	110.35
NET PROFIT	152.76	215.05	280.25	344.78	399.63
EPS	3.82	5.31	6.87	8.45	9.79

BALANCE SHEET					
SOURCES OF FUNDS :	2010	2011	2012	2013E	2014E
Capital**	39.96	40.50	40.82	40.82	40.82
Reserves Total	785.68	966.12	1,202.28	1,489.84	1,840.48
Total Shareholders Fund	825.64	1,006.62	1,243.10	1,530.66	1,881.30
Deposits	10,284.59	12,914.29	16,340.76	20,336.75	25,769.67
Borrowings	40.06	186.15	348.70	413.20	543.06
Other Liabilities & Provisions	409.15	484.46	418.10	437.24	399.38
TOTAL LIABILITIES	11,559.44	14,591.52	18,350.66	22,717.84	28,593.42
APPLICATION OF FUNDS :					
Net Block	63.04	68.53	97.73	104.26	110.79
Cash & Balance with RBI	868.53	1,052.24	814.67	1,133.19	1,233.48
Balance with Banks & Money at Call	231.67	234.08	321.44	352.17	422.65
Investments	3,210.43	3,616.23	4,586.19	5,180.04	6,024.63
Advances	6,833.46	9,255.46	12,137.46	15,537.16	20,366.11
Other Assets	352.31	364.98	393.17	411.01	435.75
TOTAL ASSETS	11,559.44	14,591.52	18,350.66	22,717.84	28,593.42

**We have not build in any capital raising in our valuation Model.

KEY FINANCIAL RATIOS					
	2010	2011	2012	2013E	2014E
Growth Ratios					
Interest Income	18.92	27.37	39.26	31.12	27.28
Net Interest Income	14.66	51.01	18.98	33.33	28.13
Net Profit	25.08	40.78	30.32	23.03	15.91
Advances	21.05	35.44	31.14	28.01	31.08
EPS	19.00	39.01	29.38	22.95	15.91
Yield Measures					
Yield on advances	13.04	12.47	13.56	14.69	14.51
Cost of funds	6.73	6.18	7.30	8.33	8.41
Spread	6.31	6.29	6.26	6.36	6.10
Net interest margin	3.15	3.64	3.40	3.33	3.40
Balance Sheet Ratio					
Capital Adequacy Ratio	12.09	11.09	10.81	10.85	11.01
Asset Quality Ratios					
Gross NPA (%)	1.36	1.21	1.01	1.08	0.98
Net NPA (%)	0.58	0.52	0.44	0.46	0.39
Profitability Ratios					
RoA	1.52	1.67	1.71	2.12	1.99
RoE	20.55	23.47	24.91	24.58	23.35

Valuations & Recommendations

The Indian Banking Sector is going through a difficult time as ebbing Corporate Sentiment, Slow Reforms and high interest rate regime has severely dented the lending activities by the Sector. Also, the onslaught of rising NPAs has hurt the Indian Banking space and continues to be a matter of concern. However, with unique business model, low risk-weighted portfolio and prudent capital allocation, City Union Bank has clearly out-shined most of its peers in the Banking space. Its business model has been skewed towards lending to traders and MSMEs and has resulted in fetching higher yields. Also, its Loan portfolio is almost completely secured by collaterals, thereby mitigating risks of bad-debts. We believe that the Bank's unique business model is highly scalable and leaves a significant room for growth and out-performance relative to the sector in the future,

At CMP of Rs.50.90, the stock trades at 1.10X FY14E BV & 5.20x FY14E EPS. **We recommend a "BUY" on the stock with a price target of Rs 69.00, assuming a P/B of 1.50X FY14E Book-Value & P/E of 7x FY14E earnings, an upside of 36%, over a period of 12 months.**

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