

27 March 2025

India | Equity Research | Company Update

City Union Bank

Banking

New LOS to boost efficiency, scale and risk management

We recently interacted with senior management and select business heads of City Union Bank (CUBK). The bank reiterated its growth guidance of 12–14% YoY for FY25 and acceleration to 15–16% YoY for FY26. We are impressed by the new LOS/IT system and scalability/uniformity it brings to the business, underwriting and monitoring. The quality of leads has improved dramatically and causes of rejections are well understood by the business teams instilling institutional learning. CUBK aims to improve the share of 'green' cases, from currently 15–20% to 35–40% over the medium term, leading to better efficiency and productivity. The initial results have been encouraging with a rise in throughput and miniscule (<0.4%) SMA2+NPA. The interaction has boosted our confidence on ~15% loan growth estimates (unchanged) for FY26E. Its recent 50–75bps rate cut in saving balances, in select buckets, should partly cushion NIM. The bank assured of no adverse impact on its derivative book.

Maintain BUY with unchanged TP

CUBK does not see any material headwinds in its gold loan business due to the recent guidelines. Our PAT estimates are revised up by 2/1% for FY25/FY26. Retain **BUY**; INR 200 TP unchanged, valuing the stock at ~1.45x FY26E ABV, in-line with RoAs. Key risk: Slower-than-expected growth.

New LOS to drive sharp rise in efficiency/scale

CUBK has successfully implemented a Loan Origination System (LOS), powered by Newgen, with the help of one of the top consulting companies. Initially, the bank tested retail (home loan/LAP) and MSME (up to INR 30mn) products on LOS. As of now, all retail and MSME loans have been added. The LOS is a 'Low Code No Code' platform with robust workflow capabilities. It has interfacing capabilities with external APIs and requires little customisation viz. UIDAI, GST, VKYC, NSDL, bureaus, ITR, UDIN, MCA, CERSAI etc.

We are more confident on 15% YoY growth estimates for FY26

Implementation of the new LOS has boosted scale, efficiency and risk architecture. Earlier, credit processing involved substantial manual intervention in verification and assessment. Under the new LOS, the entire workflow has been digitised with adequate monitoring at appropriate intervals. This has freed up a lot of capacity at branch/underwriting, which shall be channelled towards more volumes. Quality of leads has also improved dramatically, as they need to pass through minimum hurdle.

Financial Summary

Y/E March	FY24A	FY25E	FY26E	FY27E
NII (INR bn)	21.2	23.2	25.1	29.7
Op. profit (INR bn)	15.2	16.3	17.6	21.4
Net Profit (INR bn)	10.2	11.0	11.6	13.9
EPS (INR)	13.7	14.9	15.7	18.8
EPS % change YoY	8.3	8.7	5.2	20.0
ABV (INR)	104.4	120.8	136.8	154.3
P/BV (x)	1.4	1.3	1.1	1.0
P/ABV (x)	1.5	1.3	1.2	1.0
Return on Assets (%)	1.5	1.5	1.4	1.5
Return on Equity (%)	12.8	12.4	11.7	12.6

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Market Data

Market Cap (INR)	118bn
Market Cap (USD)	1,373mn
Bloomberg Code	CUBK IN
Reuters Code	CTBK.BO
52-week Range (INR)	188 /130
Free Float (%)	97.0
ADTV-3M (mn) (USD)	4.3

Price Performance (%)	3m	6m	12m
Absolute	(8.5)	(4.2)	17.2
Relative to Sensex	(7.0)	5.7	10.6

ESG Score	2023	2024	Change
ESG score	69.5	67.8	(1.7)
Environment	50.7	48.9	(1.8)
Social	55.8	59.9	4.1
Governance	85.8	82.8	(3.0)

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: SES ESG, I-sec research

Earnings Revisions (%)	FY25E	FY26E
EPS	2	1

Previous Reports

04-03-2025: [Company Update](#)

20-02-2025: [Banking: Q3FY25 review](#)

Customer experience has been enhanced and TAT has reduced from 18 days to 2 days. The automation has enabled uniformity and consistency in decision making, reducing drop-off rates and improving 'first-time-right' cases. There is likely to be a better handle on risk-based pricing too. On balance, this bolsters our confidence on ~15% YoY loan growth estimate for FY26E.

Focus on improving share of 'green' case at the cost of 'Amber'

After the initial log-in, LOS classifies the proposals into three categories, based on the rule engine – Green: automatic approval and sanctions; amber: deviation from banks rules and manual intervention required; and red: automatic rejection. Amber cases would need eye-balling and further fine-tuning. The current share of green proposals is 17–20% while Amber cases are a dominant ~60–70% and the remaining ~10% are red. CUBK is hopeful of a steady decline in amber cases as learning is getting institutionalized. It intends to improve the share of 'green' to 35–40% over the medium term, in-line with industry standards.

Sharpened risk monitoring; initial results appear encouraging

The new LOS has minimised manual intervention and personal discretion. The credit monitoring has been data driven and has concurrent review. There is clear communication on the reason for rejections; thus, there is a strong learning curve for business teams, which in turn enforces a virtuous circle. The sanctioning limit has been staggered across hubs, DGM, GM, CGM etc. based on ticket size and complexity. The focus has been on getting the right proposals 'through the door' and the learning curve has been steep. The initial results have been much encouraging. The bank has cumulatively sanctioned/disbursed around INR 80bn of new loans under the new LOS. The SMA2 as well as NPA in this portfolio has been miniscule at <20bps each. While we are not expert in distinguishing IT system across banks, CUBK now appears to be similarly placed with peers on credit monitoring.

Plain vanilla treasury operations without much risks

Management reassured that there shall be no material undue risks in the derivative portfolio. CUBK deals in forward contracts and does not have any exotic derivatives. The bank, generally, does not carry unhedged position overnight and all hedging is done externally (no internal leg). O/s FCNR deposits amount to ~USD 60mn, of which, 90% are USD deposits, where the liquidity is good. 90% of its forward contracts are settled by CCI. Bank follows AS 11 for accounting of these hedges. Hedging cost is typically 2.5–3%. Total landed cost of FCNR deposits is ~7.5–8%.

The bank used to earn ~1% arbitrage opportunity when it had surplus liquidity by swapping the INR deposits with USD without much risks. However, post the reduction in reported LCR, it has stopped this practice, as such transaction adversely impacted LCR. The bank has been calculating LCR for more than a decade according to its interpretation of the regulation. In our view, the bank was taking only the deposits that were maturing in the next 12 months, which was later brought in-line with peers. The change led to a drastic reduction in LCR. CUBK intends to create thinly-manned treasury sales vertical to improve its merchant business.

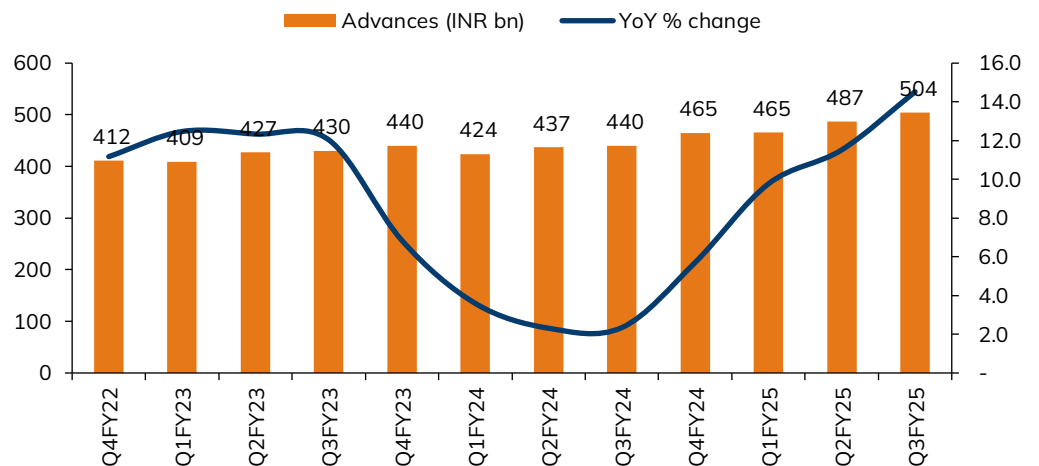
MSME to remain mainstay; calibrated scale up for new businesses

CUBK would continue to focus on the MSME segment for growth. ~70% of the MSME lending is working capital loans and the rest is capex funding. Over 80% of the MSME relationships are such where CUBK is the sole banker. The growth for MSME (ex-gold loan) is ~10% YoY. The bank would endeavour to grow 200bps higher than MSME industry growth. A large part of the growth rate can be achieved by further

streamlining processes and higher conversion of green cases from amber cases. LAP is also looked at as an attractive customer acquisition tool and it would continue to see rising traction. In northern/western states, the acquisitions would be with the help of DSAs while it would be branch-led in southern states. New retail businesses scaling-up would be calibrated and would add INR10-15 bn (2-3% of the book) by FY26E.

For the gold segment, which forms ~25% of the overall loans, the bank does not see much challenges post the revised lending guidelines, as it has been compliant with most of the stipulations. The bank had already refrained from gold loan top-ups and there is no outsourcing partner. It has started the end-use disclosure from the customers. Agri gold loans book stood at ~INR 70bn with contained LTV. 70-75% of the book is below INR 2.5-3mn ticket size.

Exhibit 1: Advances growth improving; FY25 guidance unchanged at 12-14% YoY



Source: Company data, I-Sec research

Exhibit 2: Loan growth to rise to ~15% YoY for FY26/27E vs 6-7% YoY in FY23/24



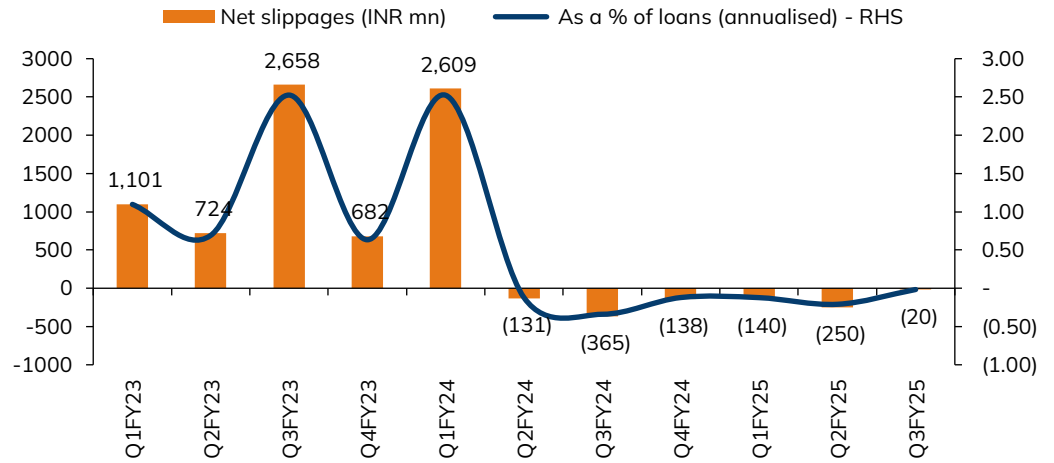
Source: I-Sec research, Company data

Exhibit 3: Cut in SA rates by 50-75bps in early buckets should cushion NIM

Savings rate (%)	Mar-22	Mar-23	Mar-24	Jun-24	Sep-24	Dec-24	Jan-25	Feb-25
Upto INR 0.1 mn	3.00	3.00	3.00	3.00	3.00	3.00	3.00	2.75
INR 0.1 mn - INR 0.5 mn	3.50	3.50	3.50	3.50	3.50	3.50	3.50	2.75
INR 0.5 mn - INR 1 mn	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.00
INR 1 mn - INR 2.5 mn	4.00	4.00	4.00	4.00	4.00	4.00	4.00	3.50
INR2.5mn -INR 500 mn	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Above INR 500 mn	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00

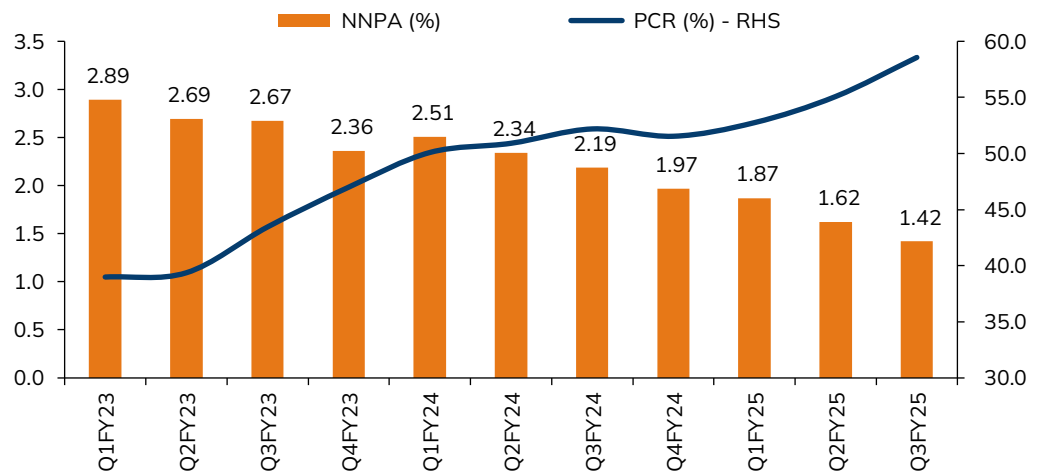
Source: Company data, I-Sec research

Exhibit 4: Net slippages negative for six consecutive quarters



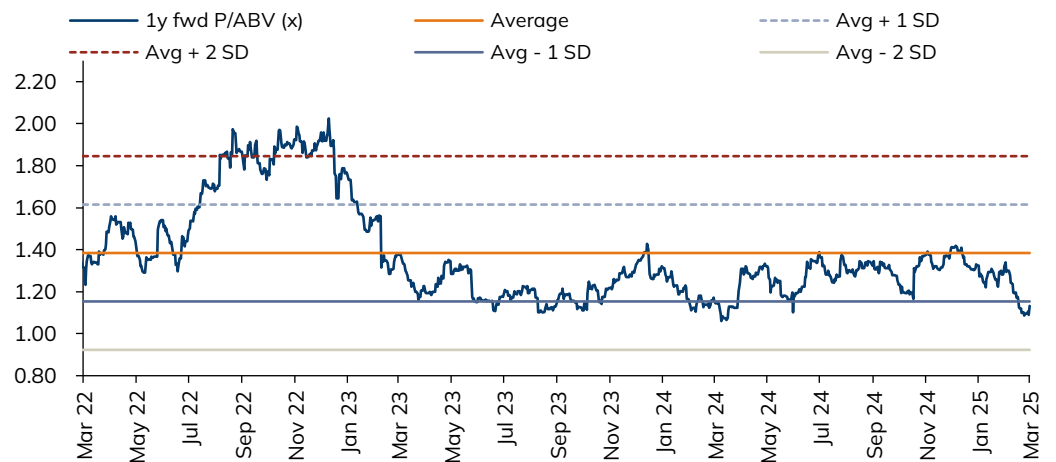
Source: Company data, I-Sec research

Exhibit 5: NNPA ratio trending lower with PCR rising



Source: Company data, I-Sec research

Exhibit 6: Valuation at its lowest levels in last 3 years; growth outlook and NIM resilience seem to have improved



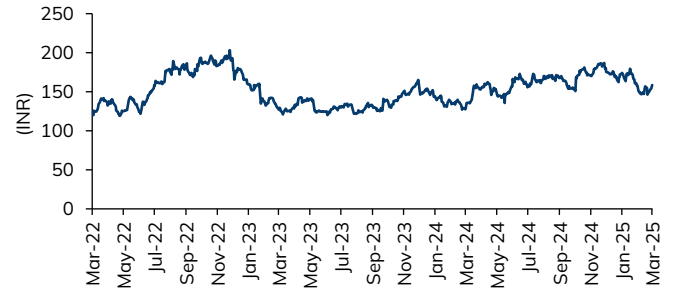
Source: I-Sec research, Bloomberg

Exhibit 7: Shareholding pattern

%	Jun'24	Sep'24	Dec'24
Promoters	0.0	0.0	0.0
Institutional investors	57.6	59.6	61.0
MFs and others	27.0	29.5	28.6
FIs/Banks	0.5	0.6	0.6
Insurance	3.7	3.5	3.8
FIIIs	26.4	26.0	28.0
Others	42.4	40.4	39.0

Source: Bloomberg, I-Sec research

Exhibit 8: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 9: Profit & Loss

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Interest income	52,706	58,315	63,850	73,316
Interest expense	31,471	35,144	38,735	43,665
Net interest income	21,235	23,171	25,115	29,651
Non-interest income	7,417	8,478	9,891	11,401
Operating income	28,651	31,650	35,007	41,052
Operating expense	13,484	15,314	17,392	19,679
Staff expense	6,138	7,241	8,385	9,540
Operating profit	15,167	16,335	17,614	21,373
Core operating profit	14,651	15,635	16,714	20,473
Provisions & Contingencies	2,860	2,537	3,092	3,939
Pre-tax profit	12,307	13,799	14,523	17,434
Tax (current + deferred)	2,150	2,760	2,905	3,487
Net Profit	10,157	11,039	11,618	13,947
Adjusted net profit	10,157	11,039	11,618	13,947

Source Company data, I-Sec research

Exhibit 10: Balance sheet

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Cash and balance with RBI/Banks	69,435	70,724	73,662	77,262
Investments	1,56,641	1,52,611	1,67,301	1,86,361
Advances	4,55,257	5,16,904	5,95,914	6,86,186
Fixed assets	2,704	2,953	3,369	3,844
Other assets	24,221	28,522	33,867	40,542
Total assets	7,08,259	7,71,715	8,74,114	9,94,194
Deposits	5,56,566	6,07,559	6,99,464	8,00,785
Borrowings	47,242	35,388	37,158	39,015
Other liabilities and provisions	20,436	34,641	32,857	36,923
Share capital	741	741	741	741
Reserve & surplus	83,274	93,387	1,03,894	1,16,730
Total equity & liabilities	7,08,259	7,71,715	8,74,114	9,94,194
% Growth	6.4	9.0	13.3	13.7

Source Company data, I-Sec research

Exhibit 11: Key ratios

(Year ending March)

	FY24A	FY25E	FY26E	FY27E
No. of shares and per share data				
No. of shares (mn)	741	741	741	741
Adjusted EPS	13.7	14.9	15.7	18.8
Book Value per share	113	127	141	159
Adjusted BVPS	104	121	137	154
Valuation ratio				
PER (x)	11.6	10.7	10.1	8.4
Price/ Book (x)	1.4	1.2	1.1	1.0
Price/ Adjusted book (x)	1.5	1.3	1.2	1.0
Dividend Yield (%)	0.9	0.8	0.9	0.9
Profitability ratios (%)				
Yield on advances	9.4	9.6	9.3	9.3
Yields on Assets	7.7	7.9	7.8	7.8
Cost of deposits	5.4	5.5	5.4	5.3
Cost of funds	4.6	4.7	4.7	4.7
NIMs	3.3	3.3	3.2	3.3
Cost/Income	47.1	48.4	49.7	47.9
Dupont Analysis (as % of Avg Assets)				
Interest Income	7.7	7.9	7.8	7.8
Interest expended	4.6	4.7	4.7	4.7
Net Interest Income	3.1	3.1	3.1	3.2
Non-interest income	1.1	1.1	1.2	1.2
Trading gains	0.1	0.1	0.1	0.1
Fee income	1.0	1.1	1.1	1.1
Total Income	4.2	4.3	4.3	4.4
Total Cost	2.0	2.1	2.1	2.1
Staff costs	0.9	1.0	1.0	1.0
Non-staff costs	1.1	1.1	1.1	1.1
Operating Profit	2.2	2.2	2.1	2.3
Core Operating Profit	2.1	2.1	2.0	2.2
Non-tax Provisions	0.4	0.3	0.4	0.4
PBT	1.8	1.9	1.8	1.9
Tax Provisions	0.3	0.4	0.4	0.4
Return on Assets (%)	1.5	1.5	1.4	1.5
Leverage (x)	8.7	8.3	8.3	8.4
Return on Equity (%)	12.8	12.4	11.7	12.6
Asset quality ratios (%)				
Gross NPA	4.0	3.1	2.4	2.2
Net NPA	2.0	1.2	0.7	0.6
PCR	51.5	62.0	70.0	72.0
Gross Slippages	2.4	1.7	1.5	2.0
LLP / Avg loans	0.7	0.7	0.7	0.7
Total provisions / Avg loans	0.6	0.5	0.6	0.6
Net NPA / Networth	10.7	6.6	4.2	3.6
Capitalisation ratios (%)				
Core Equity Tier 1	22.7	22.3	20.8	20.6
Tier 1 cap. adequacy	22.7	22.3	20.8	20.6
Total cap. adequacy	23.7	23.2	21.5	21.2

Source Company data, I-Sec research

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