IIFL

Mid-Sized Private Banks to outpace the sector

Changing banking dynamics

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RBL Bank– BUY		
CMP	Target	Upside
627	739	18.0%

Karur Vysya Bank – BUY		
CMP	Target	Upside
94	116	23.0%

City Union Bank – BUY		
CMP	Target	Upside
203	235	16.1%

Prices as on 30/08/2018

Financials (₹cr)

RBL Bank	FY19E	FY20E
Total Income	3,834	4,696
PPOP	1,848	2,301
PAT	957	1,182
P/ABV (x)	3.6	3.2

Karur Vysya Bank	FY19E	FY20E
Total Income	3,699	4,164
PPOP	1,887	2,332
PAT	456	787
P/ABV (x)	1.7	1.5

City Union Bank	FY19E	FY20E
Total Income	2,174	2,531
PPOP	1,337	1,557
PAT	666	802
P/ABV (x)	2.9	2.5

Source: Company, IIFL Research

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Private Banks capitalizing on PSU banks' waning loan market share

The market share of total private sector banks (largecap + midcap) in total domestic bank credit has improved over the last 8 years vs. public sector banks (PSU banks). It has increased from 18.1% in FY10 to 29.8% in FY18, while that of PSU banks contracted from 77.2% to 64.4% over the same period. The loss in the market share of PSU banks is attributed to their weak capital position due to higher stressed assets & provisions and balance sheet deterioration.

The credit market share of all midcap private sector banks has increased from 2.27% in FY14 to 3.22% (~₹2.9 lakh cr) in FY18. Moreover, expanding credit growth, better capital position and branch expansion would aid mid-sized Pvt. banks to further improve their credit market share to 3.78% (~₹4.2 lakh cr) by FY20E. Among the mid-sized private banks, our preferred picks are RBL Bank, Karur Vysya Bank and City Union Bank.

We prefer (1) RBL Bank, owing to its improving return profile, due to better advances & loan mix, higher CASA, lower cost ratios and better asset quality. The bank's strategy to lend to quality clients with prudent cash flows and its C&IB division's (Corporate & Institutional Banking) focus on working capital finance (~70% lending to short term working capital finance) will help it to maintain asset quality; (2) Karur Vysya Bank (KVB), due to digital banking initiative, asset quality improvement and advances growth; resolution in NCLT cases and focus on better rated corporates will lead to asset quality improvement; (3) City Union Bank (CUB), due to increasing loan book led by better traction in MSME and retail loan segments. The bank's focus on small-ticket secured lending (99% of loan portfolio secured) has helped maintain sound asset quality. Of its total loan book, ~66% comprises working-capital loans, which are completely collateralized. Further, its focus on lower slippages and higher recovery will lead to declining credit cost over next couple of years.

Comparable Valuation Matrix

Banks	CMP (₹)	Market Cap (₹ cr)	Earnings CAGR (%)	FY20E		
			FY18-20E	P/ABV (x)	RoE (%)	RoA (%)
RBL Bank	627	26,556	36.8	3.2	14.6	1.4
Karur Vysya Bank	94	7,513	50.9	1.5	11.6	1.0
City Union Bank	203	14,843	16.4	2.5	15.4	1.6
IndusInd Bank	1,874	1,12,641	26.1	3.5	19.1	2.0
Yes Bank	362	83,531	31.3	2.3	21.6	1.7

Source: Company, IIFL Research

RBL Bank

RBL Bank's strategy of lending to quality clients with prudent cash flows and its C&IB division's focus on working capital finance (~70% lending to short term working capital finance) has helped maintain asset quality. We expect its slippage ratio to decline from 1.4% in FY18 to 0.7% in FY20E, due to its focus on lending to better rated corporates. We project the GNPA ratio to decline by 30bps over FY18-20E to 1.1%. In addition to improving loan book in coming years, it will also see an improvement in NIMs supported by better product mix and lowering cost funding profile. We project its NIM to surge by 41bps over FY18-20E to 4.2%. We project RoA and RoE to increase by 24bps and 317bps to 1.4% and 14.6% respectively over FY18-20E.

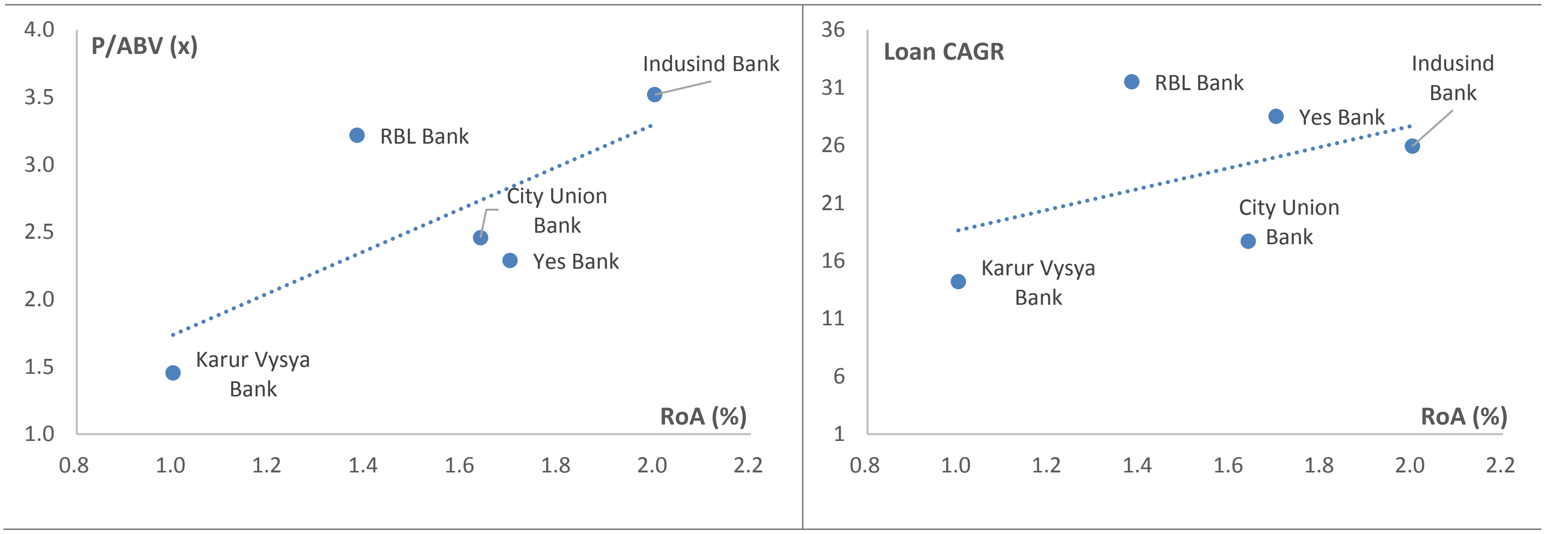
Karur Vysya Bank

Karur Vysya Bank, in H2FY19, will launch all its products and services on a completely digital platform, which will provide a boost to its loan book. Further, we believe the bank is in its tail end in terms of corporate NPAs. We expect its slippage ratio to decline from 4.6% in FY18 to 1.3% in FY20E (due to declining share of corporate loans in total loans, which accounts for ~80% of slippages). According to us, the GNPA ratio would decline by 136bps to 5.2% over FY18-20E due to lower slippages and higher recoveries owing to resolution in NCLT cases. Over FY18-20E, lower loan loss provisions and interest reversal (due to lesser slippages) would drive an improvement in return ratios. We forecast its RoA & RoE to increase by 48bps and 540bps to 1% and 11.5% respectively over FY18-20E.

City Union Bank

City Union Bank to benefit from its increasing loan book led by better traction in MSME and retail segments. The proportion of MSME + retail in total loan book is expected to increase by 160bps over FY18-20E. Its focus on small-ticket secured lending has helped to maintain sound asset quality in the past few years despite the industry being under severe asset quality stress. Its focus on lower slippages through better NPA management (99% of its loan book is secured) and higher recovery will lead to declining credit cost over next couple of years. We expect slippage ratio to decline from 2.1% in FY18 to 1.4% in FY20E. In addition, focus on high yielding products, better CASA & CD ratio and lower cost ratios to support return profile. Its return ratios are likely to remain superior to that of regional peers, including SFBs over FY18-20E. We forecast its RoA & RoE to increase by 7bps and 13bps to 1.64% and 15.4% respectively over FY18-20E.

Exhibit 1: Peer Comparison Charts



Source: RBI, Company, IIFL Research

Improving return metrics to aid valuations

RBL Bank

RBL Bank enjoys better asset quality than its peers and has delivered industry leading loan growth over last few years. The stock has traded at ~3x P/BV over last 1.5 years. Going ahead, we believe, earnings growth potential (36.8% CAGR over FY18-20E) & improving return profile over FY18-20E, makes a case for re–rating the stock's multiple. It presently trades at 12-15% discount to its peers, and we believe that the valuation gap should narrow over next one year.

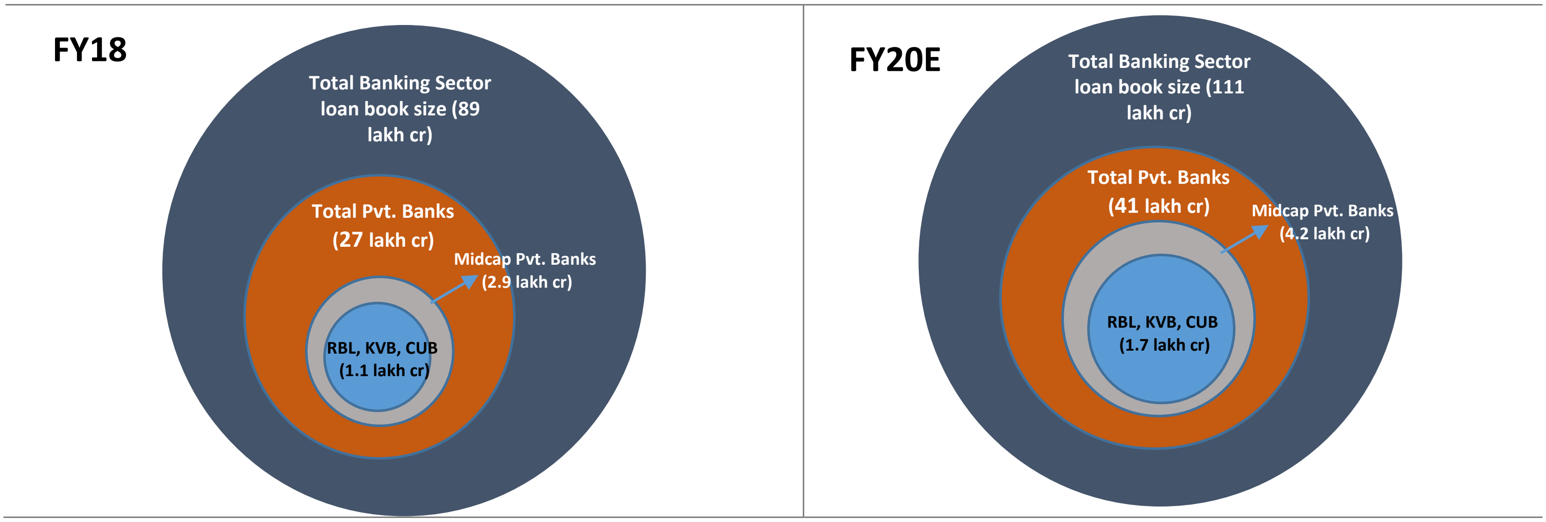
Karur Vysya Bank

Karur Vysya Bank, in H1FY18, was trading at attractive valuation i.e. above 2x P/BV, on the expectation of waning asset quality concerns and better loan growth. However, on account of demonetization, its exposure to the SME segment and February 12 circular by RBI, the bank's asset quality deteriorated in FY17 and FY18, which resulted in the stock trading at lesser multiple. However, as things are expected to improve on asset quality front coupled with better earnings & improved return ratios over next couple of years, we believe the stock would fetch above 2x multiple. Karur Vysya Bank is expected to deliver earnings CAGR of 50.9% over FY18-20E aided by higher NII and asset quality improvement providing a room for valuation upgrade.

City Union Bank

City Union Bank, over last few years, has witnessed relatively better and stable valuations owing to consistent return profile vis-à-vis midsized private bank peers. It is expected to continue with higher return profile going ahead. It has better grip on asset quality as ~99% of its portfolio is secured. The stock, over last 1.5 years, has fetched the valuation multiple in the range of 2.1-2.6x P/BV. We believe, CUB, as a compounding play with greater bottom-line visibility over the medium term should continue to fetch higher multiple.

Exhibit 2: Improving advances share of mid-sized private banks over FY18-20E



Source: RBI, Company, IIFL Research

The credit market share of all midcap private sector banks in total bank credit is expected to increase from 3.22% in FY18 to 3.78% in FY18.

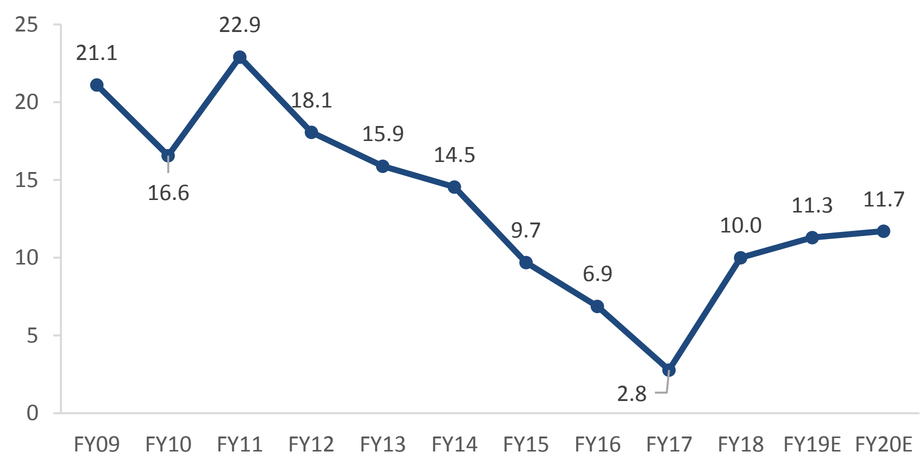
The credit market share of all midcap private sector banks has increased from 2.27% in FY14 to 3.22% (~₹2.9 lakh cr) in FY18. Moreover, expanding credit growth, better capital position and branch expansion would aid mid-sized Pvt. banks to further improve their credit market share to 3.78% (~₹4.2 lakh cr) by FY20E. On the other hand, the total private banks advances market share is expected to improve from 29.8% in FY18 to 37.1% in FY20E. On the advances growth front, similar to their large private peers, opportunities continue to exist for mid-size private banks to gain market share from PSU banks. Moreover, mid-size banks, due to their branch expansion spree across India as compared to their regional dominance earlier, presents them an opportunity to improve advances. Among the mid-size private banks, we believe RBL Bank, Karur Vysya Bank and City Union Bank are better placed in terms of their capital adequacy ratio, which remains strong at 14.6%, 14.1% and 16.1% respectively for Q1FY19. Adequate capital position will aid them to improve their advances market share in total banking advances, without any dilution risk in the medium term. We forecast 21.4% advances CAGR for RBL, KVB and CUB (together) over FY18-20E to ~₹1.7 lakh cr, as against 11.5% advances CAGR to ₹111 lakh cr for total banking sector over similar period. The credit market share for RBL, KVB and CUB (together) is expected to increase from ~1.3% in FY18 to ~1.5% in FY20E.

Credit growth for Indian banks reviving from lows

We forecast the total Scheduled Commercial Banks credit growth to be more than 11% for FY19E and FY20E

Total Scheduled Commercial Banks' credit growth has consistently fallen over FY11-17 (declined to 2.8% in FY17 from 22.9% in FY11). The slower growth is mainly attributed to muted corporate credit offtake, whose proportion in total loan growth has declined from 37.3% in FY11 to 33% in FY17. The banks were reluctant to fund corporate expansion plans, since many of them had overleveraged balance sheet and were incapable of servicing loans. Additionally, poor capital position of PSU banks due to NPA issues and certain PSU banks under PCA also contributed to slower credit growth. In FY17, the banks' loan growth suffered due to demonetization and GST related disruptions. Moreover, favorable rates in the bond markets had led to shift in short term corporate borrowing away from banks. The credit growth for Indian banks is finally reviving from FY18 onwards. The banks are now seeing higher capital expenditure loans demand currently (earlier the demand was of working capital loans). Further, yields in the bond markets have risen, making bank credit more attractive. We forecast the total Scheduled Commercial Banks credit growth to be more than 11% for FY19E and FY20E. We believe the government's PSU banks recapitalization programme, insolvency and bankruptcy proceedings, improving commodity cycle, better GDP, increasing private capex & consumption patterns will lead to double digit credit growth for next few years.

Exhibit 3: Total Scheduled Commercial Banks credit growth yoy (%)



Source: RBI, Company, IIFL Research

The credit uptick in the corporate segment is expected to improve mainly driven by the capex in consumer driven industries such as automobiles, auto ancillaries and agro-based industries. Further, sectors such as cement, roads, textiles, engineering, food processing, chemical and chemical products renewable energy and oil & gas are also seeing investments, which will create the demand for corporate credit. Improving commodity cycle will also help in credit demand from metal sector. Further, as per RBI, the MSME sector, which was grappling with GST & demonetization issues has rebounded. During Q1FY19, bank credit to MSMEs increased by ~8.5% yoy (to pre-demonetization levels) and we believe the growth momentum in MSME credit to continue for the coming years. Further, retail lending which has turned out to be a key profit driver for banks will lead the overall banking loan growth in years to come.

Total Banks advances expanded at 12.9% CAGR over FY09-18

The total advances expanded to ~₹89 lakh cr in FY18 from ₹~30 lakh cr in FY09

The total banks advances expanded to ~₹89 lakh cr in FY18 from ~₹30 lakh cr in FY09, expanding at 12.9% CAGR. The growth was largely contributed by private sector banks, registering 18.6% advances CAGR over similar period vs. PSU banks growth of 10.9% CAGR. Retail advances was the primary contributor to overall banking sector advances growth, while corporate loan growth was muted. Credit growth for the total banking system touched 11% yoy in May 2018 (highest growth since September 2016), largely attributed to retail loans. Retail loans grew ~20% yoy in May2018 and should continue to drive growth for the sector, with large and mid-sized private banks increasing focus on unsecured lending (credit cards, personal loans and business loans), which remains the fastest growing sub-segment within retail loans (up 27% yoy in May 2018).

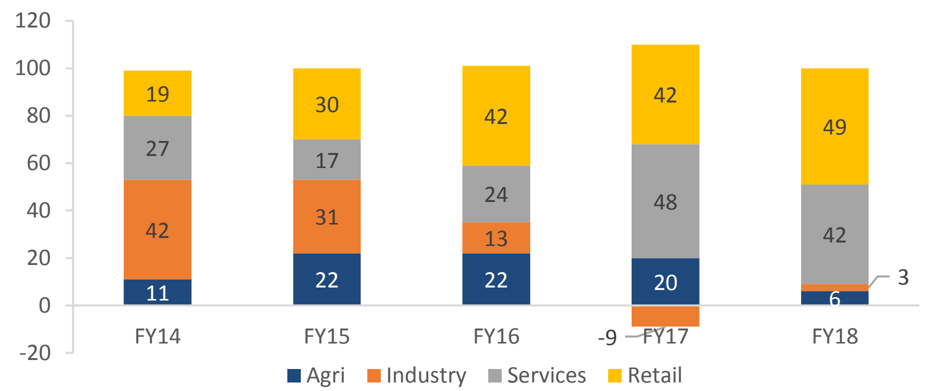
Banking industry has registered 18% yoy retail loan growth in FY18 as against 10% loan growth for the banking industry

Retail segment growth to lead the overall loan growth

The retail segment represents more than one-fifth (~23% as of March 2018) of overall banking credit, and in turn, derives a major share from housing finance (forms ~51% of retail loans in FY18). Banking industry has registered 18% yoy retail loan growth in FY18 as against 10% loan growth for the banking industry and less than 1% for the corporates. In fact, retail loans in FY18 have contributed 49% to total banking incremental loan growth. Most of the banks are pushing retail loans due to their high margin and better asset quality benefits. Retail lending has turned out to be a key profit driver for banks, as there exists high impairment in corporate loan portfolio. While corporate loan growth is expected to recover, it is likely to lag the overall loan growth. Granular retail loans are set to grab a larger share of the pie. Private banks are well-poised to capture this opportunity led by low penetration and better capital position.

Retail loans contributed 49% of incremental growth in FY18

Exhibit 4: Retail loans contributed 49% of incremental growth (%)

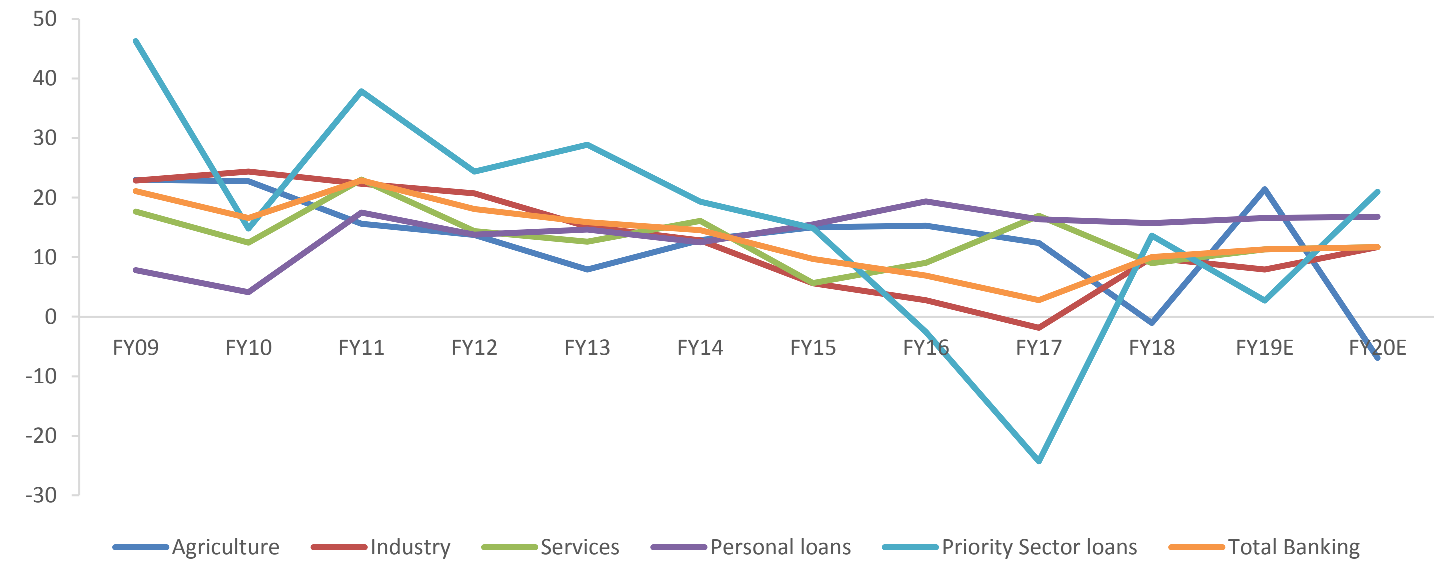


Source: RBI, Company, IIFL Research

RBL Bank, Karur Vysya Bank and City Union Bank are also focusing towards high margin retail loans. We expect the credit growth of Karur Vysya Bank and City Union Bank to be driven by Retail and MSME segments. For RBL Bank, both wholesale and non-wholesale businesses to contribute towards its loan book growth (~31.5% loan book CAGR over FY18-20E) above industry average. Karur Vysya Bank's strategy is to increase the more granular retail/MSME portion and its digital banking initiative, which will aid its loan book growth (~14.2% loan book CAGR over FY18-20E). City Union Bank's working capital loans to SME & MSME (52% advances share) and retail loans would continue to drive loan growth (~17.7% loan book CAGR over

FY18-20E). RBL Bank and Karur Vysya Bank's share of retail loans in total loans is expected to improve from 22.1% & 16.6% in FY18 to 25.6% & 19.9% respectively in FY20E. Loan book inclination towards retail will aid them into higher NIMs and better asset quality. City Union Bank's secured lending model in the form of small ticket size loans (mostly working capital loans) provides cushion to asset quality.

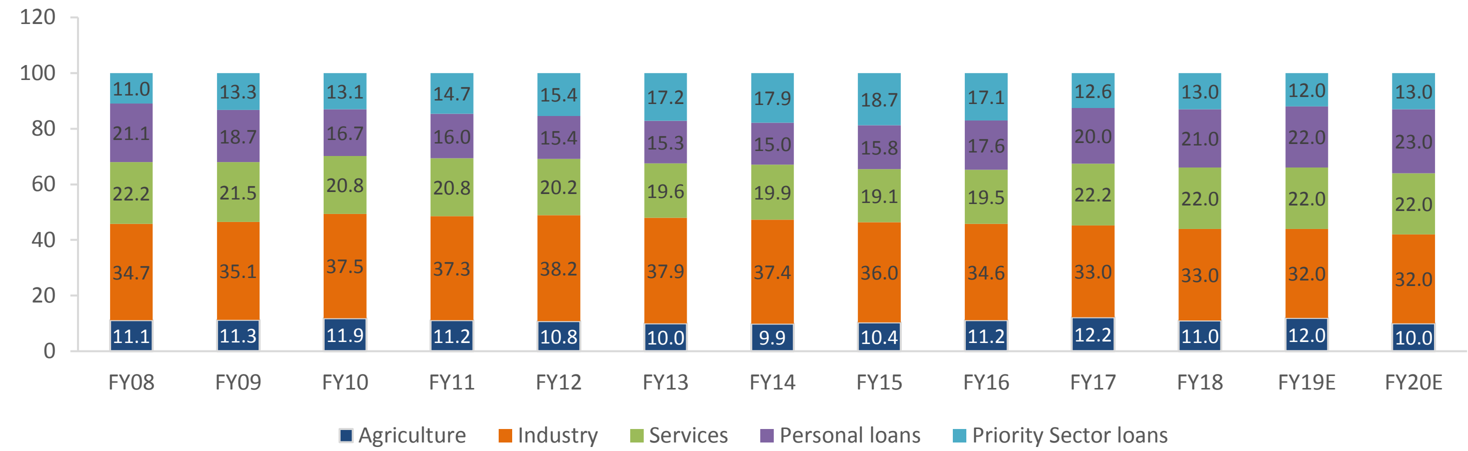
Exhibit 5: Sectoral growth (%) of non-food advances



Source: RBI, Company, IIFL Research

Total banks non-food advances have grown at a CAGR of 14.5% during FY09-14 led by demand from both corporate & retail loans. However, over FY15-18 it has decelerated to just 8.6% CAGR. Slower credit growth during the period is attributed to slowdown that commenced in 2015. Credit to industries, which accounted for ~36% in FY15 has contracted to ~33% in FY18. Within this, infrastructure sector was a larger hit. The retail loans segment share expanded from ~16% in FY15 to ~21% in FY18. Within retail loans, auto loans, consumer durables and credit card loans witnessed an improvement. We expect the non-food advances to grow at 11.5% CAGR over FY18-20E, largely led by retail loans. Private Banks are well-poised to capture this opportunity led by low penetration levels in retail loans and their strong capital position.

Exhibit 6: Total banking non-food advances mix (%)



Source: RBI, Company, IIFL Research

Exhibit 7: Increasing share (%) of Housing & Personal Loans in total retail loans

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Housing	49.9	49.7	51.4	50.9	50.7	50.9	53.3	53.9	51.1	53.1	51.1
Vehicle	11.2	11.0	10.9	10.6	11.4	12.4	10.5	10.7	10.5	10.5	10.3
Credit Cards	5.1	5.0	3.4	2.6	2.6	2.8	2.5	2.6	2.6	3.2	3.6
Personal Loans	18.5	18.7	17.8	21.2	20.3	19.8	19.8	20.2	24.9	23.2	26.6
Others	15.2	15.6	16.5	14.7	15.0	14.2	13.9	12.6	10.9	10.0	8.4

Source: RBI, Company, IIFL Research

We expect retail loans to grow at 16.7% CAGR over FY18-20E

The total retail loans have grown at 13.9% CAGR over FY08-18. The above data suggests that housing and personal loans have been the biggest contributors with ~51% and ~27% share of retail loans respectively. These segments have grown at CAGR of 14.1% & 18.1% over FY08-18 respectively. Both these segments are poised for further growth, backed by demand for housing and personal finance. The demand for unsecured personal loans/credit cards/ other retail loans has gone up rapidly. This is in-line with the strategy of banks looking at profitable ventures to drive growth. Though we expect gradual recovery in corporate loan growth, we believe retail loans to remain a key driver of total banking sector loan growth in coming years. We expect retail loans to grow at 16.7% CAGR over FY18-20E. This will be led by steady growth in car financing, a better CV financing outlook and under penetration in unsecured lending segments, which would likely expand the pie of granular retail loans. Besides, better availability and ease of credit (doorstep financing), cross sell opportunities and digitalization will drive more consumers to avail credit.

Exhibit 8: Market share of PSU & Private banks in loans and deposits

Rs lakh cr	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
PSU Banks (incl. SBI group)													
Loans	11	14	18	23	27	33	39	45	51	55	56	56	57
Deposits	16	20	25	31	37	44	50	57	66	72	75	81	85
Pvt Banks													
Loans	3	4	5	6	6	8	10	11	13	16	19	22	27
Deposits	4	6	7	7	8	10	12	14	16	18	21	26	30
Banking Industry													
Loans	15	20	25	30.0	35	43	51	59	67	74	79	81	89
Deposits	22	27	33	41	47	56	65	74	85	94	101	111	123
Loan market share (%)													
PSU (incl. SBI group)	72.9	72.7	72.6	75.3	77.2	76.9	76.4	76.1	75.7	74.1	70.8	68.5	64.4
Pvt	20.6	20.9	20.9	19.2	18.1	18.6	19.0	19.4	19.9	21.4	24.6	27.3	29.8
Deposit market share (%)													
PSU (incl. SBI group)	75.0	73.9	73.9	76.6	77.8	77.9	77.5	77.3	77.2	76.3	74.2	72.7	68.7
Pvt	19.8	20.5	20.3	18.1	17.3	17.9	18.2	18.8	18.7	19.4	21.3	23.1	24.6

Source: RBI, Company, IIFL Research

The above table clearly depicts that private banks have performed well and capitalized on the opportunities by delivering credit growth at 19.5% as against 14.7% for PSU banks over FY06-18. This was achieved due to better asset quality and higher capital position of private banks as against PSU banks. Similarly, deposit growth of private banks has also improved by 17.7% CAGR as against 14.8% CAGR for PSU banks over FY06-18. Over the similar period, the CD ratio of private banks has improved by 1,459bps to ~88%.

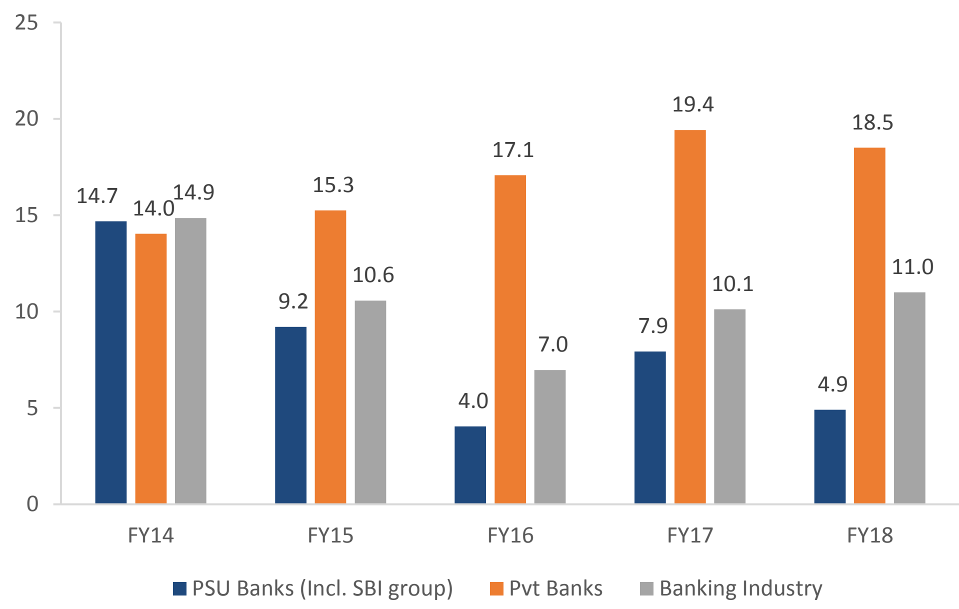
The total banks deposits expanded to ~₹123 lakh cr in FY18 from ~₹22 lakh cr in FY06, expanding at 15.6% CAGR

Deposit base of Pvt. banks growing ahead of industry

The total banks deposits expanded to ~₹123 lakh cr in FY18 from ~₹22 lakh cr in FY06, expanding at 15.6% CAGR. Pvt. banks were more successful in raising deposits across all categories as compared to PSUs. The growth was largely contributed by private sector banks, registering 17.7% deposits CAGR over similar period as against PSU banks growth of 14.8% CAGR.

Private sector banks, registering 17.6% deposits CAGR over FY14-18 as against PSU banks growth of 6.5% CAGR over similar period

Exhibit 9: Deposit growth of PSU and Pvt. banks over FY14-18 (%)



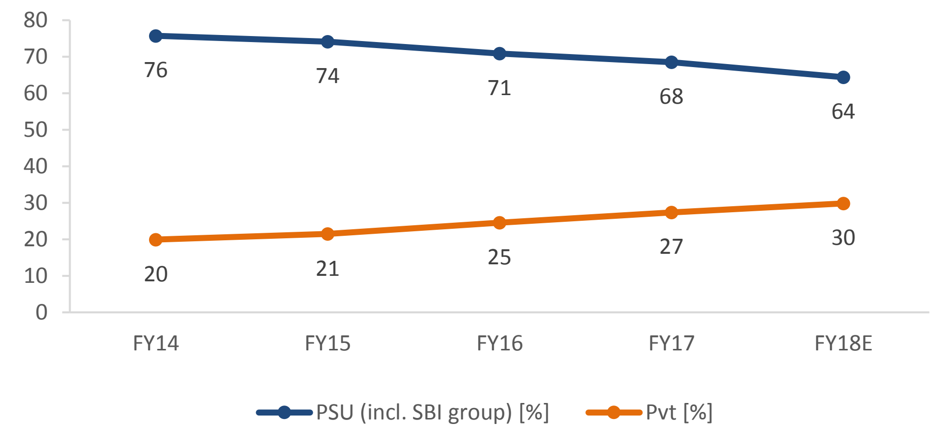
Source: Source: RBI, Company, IIFL Research

Of the deposits, current and savings accounts (CASA) are low cost and sticky in nature. Certificate of Deposits (CDs) and bulk deposits from corporate and institutional depositors are typically more volatile than retail and household deposits. RBL Bank, Karur Vysya Bank and City Union Bank have higher proportion of retail deposits in the total mix. The rise in retail deposits has brought about stability in the bank's liability franchise, lending stability to earnings, as the cost of these tend to be less volatile than bulk deposits. RBL Bank is one of the few banks (in addition to IIB, KMB and YES) that offers differential interest rates on their saving account deposits. This has led to robust CASA accretion over the past 8 quarters (from ~18.3% to ~24.4% in Q1FY19). RBL Bank and Karur Vysya Bank's CASA share in total deposits is expected to improve from 24.3% & 29.1% in FY18 to 28.3% & 32.3% in FY20E respectively. As a consequence, the cost of deposits of RBL Bank and Karur Vysya Bank are expected to decline from 6.3% & 6.01% in FY18 to 5.55% & 5.62% respectively in FY20E, in turn contributing to NIM expansion. City Union Bank's CASA ratio is expected to improve from 28% in FY18 to 32% in FY20E, which will lead to 43bps decline in cost of deposits to ~5.9% over the same period.

Increasing market share of Pvt. banks due to poor asset quality of PSU banks

The loan market share of PSU banks has been decreasing over FY14-18 due to worsening asset quality, while private banks have witnessed an upward trend in loan market share (refer exhibit 10).

Exhibit 10: Loan market share for PSU vs. Private banks



Source: RBI, Company, IIFL Research

The GNPA of PSU banks stood elevated at 15.6% for FY18 end and as per RBI June 2018 stability report, their GNPA may increase to 16.3% in FY19E

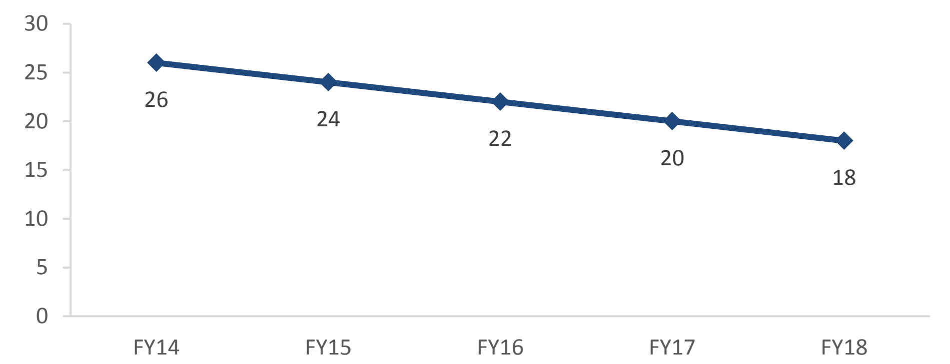
Private sector banks had an almost 100% share in the incremental bank credit over last one year, whereas public sector banks are plagued with asset quality issues leading to higher credit costs and losses. The stressed assets of PSU banks hovered around ~16.6%, while that of private banks remained lower at 4.4% as of March 2018. The GNPA of PSU banks stood elevated at 15.6% for FY18 end and as per RBI June 2018 stability report, their GNPA may increase to 16.3% in FY19E. The stressed assets of the PSU banks, which over last several years has gone up, has led to jump in provisioning requirement for these banks.

The falling quality of assets has necessitated sizeable provisioning and deleveraging, thereby eroding profitability and capital position of PSU banks. The CRAR (Capital Risk Adjusted Ratio) of the PSU banks remains lower at 11.2% in FY18, as compared to private banks at 15.9%. The strong capital position of total private banks vis-à-vis total PSU banks presents an opportunity for private banks to gain market share in total bank credit in the coming years. The market share of private sector banks in total banking sector advances is expected to increase to ~37% by FY20E from ~20% as on March 31, 2014 and ~30% as on March 31, 2018.

Prompt Corrective Action an opportunity for Pvt. Banks

RBI has put in place some points to cut risk weight exposures, reduce capital consumption, freeze on recruitment and branch expansion, limit exposure to risky loans & higher provisioning requirements and control costs, etc. The process or mechanism under which such actions are taken is known as Prompt Corrective Action, or PCA. The banks under PCA are losing the market share in advances to total Scheduled Commercial Banks (SCB; refer exhibit 3) due to the restrictions placed on them to expand their business beyond a certain level. Given PSU banks capital constraints and ~30% of PSU bank loans falling under PCA, private banks have continued to gain market share.

Exhibit 11: Advances of banks under PCA as % of total SCB advances



Source: Company, IIFL Research

The market share of banks under PCA in total SCB credit over FY14-18 has declined by 800bps to 18%

The market share of banks under PCA in total SCB credit over FY14-18 has declined by 800bps to 18%. Their market share is expected to decline further until the restrictions are put in place. The restrictions are intended to restore the health of the banks. The RBI's Financial Stability Report (June 2018) estimates that the 11 PCA banks may experience a worsening of their GNPA ratio from 21% in March 2018 to 22.3% by March 2019E. Moreover, the report projects that the CRAR of PCA PSU banks to fall from 10.8% in March 2018 to 6.5% in March 2019, in the absence of capital infusion. Thus, we believe that the mid-size private banks with better capital adequacy position stand to benefit from this. Private sector banks' (PVB) market share is expected to increase in the foreseeable future. Most of this market share is likely to be wrested away from PCA public sector banks.

Exhibit 12: List of 11 PSU banks under PCA with widening net loss and poor asset quality

(Prompt Corrective Action)	Figures for FY18				Net Profit (₹ cr.)		NNPA (%)	
	GNPA (%)	NNPA (%)	ROA (%)	CRAR (%)	FY17	FY18	FY17	FY18
Bank of India	16.6	8.3	-0.9	12.9	-1,558	-6,044	6.9	8.26
United Bank	24.1	16.5	-1	12.9	220	-1,445	10.02	16.49
Dena Bank	22	12	-1.6	11.1	-864	-1,923	10.66	11.96
Bank of Maharashtra	19.5	11.2	-0.7	11	-1,373	-1,146	11.76	11.24
UCO Bank	24.6	13.1	-1.9	10.9	-1,851	-4,436	8.94	13.1
Oriental Bank	17.6	10.5	-2.3	10.5	-1,094	-5,872	8.96	10.48
IDBI Bank	28	16.7	-2.5	10.4	-5,158	-8,238	13.21	16.69
I O B	25.3	15.3	-2.3	9.3	-3,417	-6,299	13.99	15.33
Corporation Bank	16.2	11.7	-1.7	9.2	561	-4,054	8.33	11.74
Central Bank	21.5	11.1	-1.6	9	-2,439	-5,105	10.2	11.1
Allahabad Bank	16	8	-2	8.7	-314	-4,674	8.92	8.04

Source: RBI, Companies, IIFL Research

These 11 banks under PCA have reported elevated level of NPAs over FY17-18, which led to higher provisioning requirement.

These 11 banks under PCA have reported elevated level of NPAs over FY17-18, which led to higher provisioning requirement. The higher provisions resulted into deep losses for these banks. The net NPAs of the five PCA banks were uncomfortably high at the end of March 2018. These are IDBI Bank (net NPA ratio of 16.69%), United Bank of India (16.49%), Indian Overseas Bank (15.33%), Dena Bank (11.96%) and Bank of Maharashtra (11.24%). The 11 stressed banks make up for 30% of deposits and 30% of advances of all the 21 PSU banks.

These 11 banks together have reported loss of ₹17,286cr and ₹49,237cr in FY17 and FY18 respectively, due to higher provisions on non-performing assets. This in turn, has deteriorated their capital adequacy position, restricting them to expand their business. Most of these banks have CRAR close to the minimum levels prescribed by the RBI, which is at 9%.

RBL Bank Ltd

CMP: ₹627; 1-year target: ₹ 739

Sector	Banking
Recommendation	BUY
Upside	18%

Stock Data

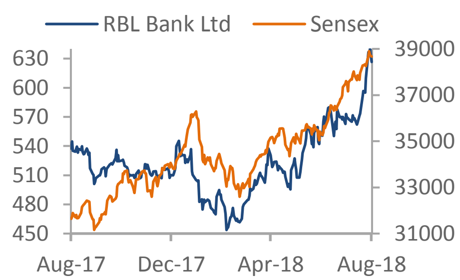
Sensex	38,690
52 Week h/l (₹)	652/433
Market cap (₹ Cr)	26,637
BSE Code	540065
NSE Code	RBLBANK
FV (₹)	10
Div yield (%)	0.34

Shareholding Pattern

	Dec-17	Mar-18	June-18
Promoters	0.0	0.0	0.0
DII+FII	30.70	32.50	35.38
Individuals	69.30	67.50	64.62

Source: ACE Equity, IIFL Research

Share Price Trend



Prices as on 30/08/2018

RBL Bank (one of the fastest growing private banks) is likely to see improving return profile over next couple of years, due to improving advances & loan mix, higher CASA, lower cost ratios and improving asset quality. We forecast RoA and RoE to increase by 24bps and 317bps to 1.4% and 14.6% respectively over FY18-20E. Considering the multiple levers, we value the stock at 3.6x FY20E P/ABV to arrive at the 12-months target price of ₹739.

Changing loan mix and improving CASA & CD ratio to expand NIMs: The NIMs of RBL Bank have improved by 70bps to 3.8% over FY16-18 led by rising CASA share, higher CD ratio and improving proportion of high margin retail segment (+491bps over FY16-18 to ~22%). The retail businesses had broken even in FY18 and would further scale up, aiding margins. The proportion of higher yielding assets from the retail segment (share of credit card & LAP together form ~75% of retail business) in the entire asset mix is further expected to improve from ~22% in FY18 to ~26% in FY20E. We forecast its CASA share in total deposits to rise from 24.3% in FY18 to 28.3% in FY20E. Moreover, higher credit to deposit ratio (from 91.7% to 95.3% over FY18-20E) to also support margin improvement. Thus, the NIM expansion will be supported by improving product mix and lowering cost funding profile. We forecast its NIM to surge by 41bps over FY18-20E to 4.2%.

Outlook & Valuation: We believe the stock deserves higher multiple given decent earnings growth, steady asset quality, improving business mix and loan growth above industry average. We expect the bank to report industry leading loan CAGR of ~31.5% over FY18-20E. We forecast revenue and PAT CAGR of 27.5% and 36.8% respectively over FY18-20E.

Financial Summary

Figures in ₹ Cr	FY17	FY18	FY19E	FY20E
Net interest income	1,221	1,821	2,594	3,245
Total net operating income	1,977	2,889	3,834	4,696
Pre-provision profit	920	1,341	1,848	2,301
Net profit	447	632	957	1,182
P/E (x)	52.8	41.2	27.3	22.1
P/ABV (x)	5.6	4.0	3.6	3.2
ROE (%)	12.2	11.5	13.5	14.6
ROA (%)	1.0	1.1	1.4	1.4

Source: Company, IIFL Research

We forecast RoA & RoE to increase by 24bps and 317bps respectively over FY18-20E

Balance Sheet

Figures ₹ Cr	FY17	FY18	FY19E	FY20E
Sources of funds				
Share Capital	375	420	420	420
Total Reserves	3,961	6,261	7119	8198
Networth	4,336	6,681	7,539	8,618
Minority interest		19		
Deposits	34,588	43,883	57073	73053
Borrowings	7,980	9,261	9910	10207
Other Liabilities & Provisions	1,771	2,033	2,237	2,460
Total Liabilities	**48,676**	**61,877**	**76,758**	**94,338**
APPLICATION OF FUNDS				
Goodwill on consolidation		18		
Cash balance with RBI	2,948	2,589	2,411	2,848
Balances with banks	1,246	1,721	1807	1897
Investments	13,482	15,397	16475	17628
Advances	29,449	40,268	53959	69607
Gross block	259	340		
Net Block	259	340	408	489
Other Assets	1,292	1,544	1,699	1,869
Total Assets	**48,676**	**61,877**	**76,758**	**94,338**

Source: Company, IIFL Research

Key Ratios

	FY17	FY18	FY19E	FY20E
Margins (%)				
NIM	3.3	3.8	4.1	4.2
Interest Spread	2.4	2.9	3	3.1
Profitability (%)				
Cost to Income	53.4	53.6	51.8	51.0
CD Ratio	85.1	91.7	94.5	95.3
CASA	22.0	24.3	27.4	28.3
Assets Quality (%)				
Gross NPA	1.20	1.40	1.20	1.03
Net NPA	0.64	0.78	0.50	0.33
Provision Coverage	59.6	57.6	58.0	58.0
Capital Adequacy (%)				
CAR	13.7	15.3	14.5	12.8

Source: Company, IIFL Research

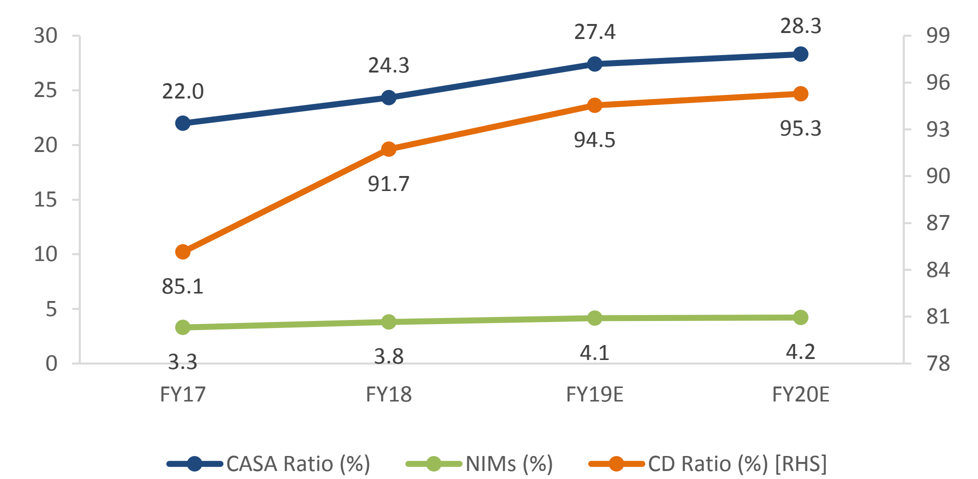
DuPont Analysis

Y/E March	FY17	FY18	FY19E	FY20E
NII / Assets (%)	2.6	3.0	3.5	3.5
Other Income / Assets (%)	1.6	1.8	1.7	1.6
Total Income / Assets (%)	4.2	4.8	5.1	5.1
Cost / Assets (%)	2.2	2.6	2.7	2.6
PPOP / Assets (%)	2.0	2.2	2.5	2.5
Provisions / Assets (%)	0.5	0.6	0.5	0.5
PBT / Assets (%)	1.4	1.6	2.0	2.0
Tax rate (%)	34.6	34.4	34.4	34.4
ROA (%)	0.9	1.1	1.3	1.3
Leverage (x)	11	9	10	11
RoE (%)	10.3	9.5	12.7	13.7

Source: Company, IIFL Research

Exhibit 1: Improving CASA & CD ratio to aid NIM expansion

The NIM expansion will be supported by improving product mix and lowering cost funding profile



Source: Company, IIFL Research

Improving loan mix towards higher yielding assets, rising CASA proportion in total deposits and improving credit-deposit ratio to help NIM expansion.

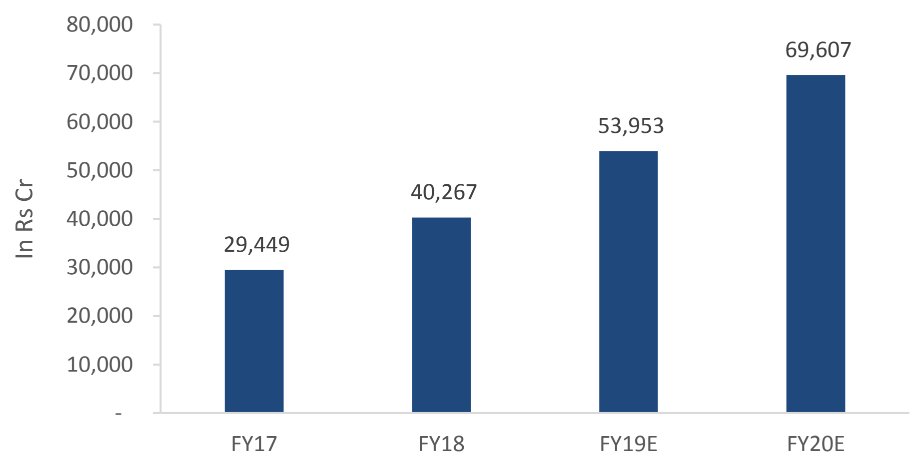
Loan book to grow at 31.5% CAGR over FY18-20E

Loan book to grow at 31.5% CAGR over FY18-20E, its non-wholesale business to grow higher than wholesale business, led by higher Retail, MSME and Micro-Banking segments

RBL Bank's loan book growth to come from across the segments (whole sale and non-whole sale businesses). Under its DB&FI segment, both Micro-Banking and MSME advances grew by 65% yoy and 76% yoy respectively in FY18, aided by distribution expansion and the better growth momentum. This trend would continue for at least next couple of years. Retail loan book is expected to register 41.5% CAGR over FY18-20E, led by LAP and credit card business. Its credit card business saw ~180% yoy growth ending FY18 with a total of ~8 lakh cards. RBL's Credit Card retail spends are among the top 5 in the industry with revenue as percentage of spends being the highest.

On a relatively smaller base of ₹40,267cr advances in FY18, we forecast 31.5% loan book CAGR over FY18-20E. The bank's capital adequacy ratio remains strong at 14.6% as at Q1FY19 end. The strong capital position should allow the bank to grow comfortably without raising fresh equity for next ~1.5 years. The management expects to gain market share in corporate space due to muted competitive environment.

Exhibit 2: Loan growth aided by across the business traction



Source: Company, IIFL Research

RBL Bank is expecting market share improvement in its wholesale book due to muted competitive environment in corporate segment on the back of poor capital position of PSU banks. Its non-wholesale business to grow higher than wholesale business, led by Retail, MSME and

Micro-Banking segments. These factors to contribute towards the advances growth of the bank.

Improving asset quality to aid profitability

We expect its credit cost to decline by 26 bps to 0.7% over FY18-20E.

RBL Bank's strategy of lending to quality clients with prudent cash flows and C&IB's (Corporate & Institutional Banking) focus on working capital finance (~70% lending to short term working capital finance) has helped maintain its asset quality. GNPA ratio has been on the lower side despite the stupendous loan growth over the years. Its credit cost for FY18 stands at 96bps, which is expected to reduce over FY18-20E, through product and segment diversification. We believe the GNPA ratio would decline by 30bps over FY18-20E to 1.1%, given the management's ability to contain asset quality in the past. Credit cost (ex-financial inclusion) and DB & FI are trending down and we expect them to improve further in FY19E. The bank's commercial banking, which is SME and mid-market book, used to have higher NPA historically, which is also declining now. The restructured standard assets portfolio has decreased to 0.08% as at March 31, 2018 from 0.18% yoy. We expect its credit cost to decline by 26bps to 0.7% over FY18-20E.

Other income to grow at 16.5% CAGR over FY18-20E

For FY18, core fees grew 41% yoy. As in the past, we continue to see strong granular growth across distribution, credit card, client Fx income, and general banking fees. We expect the growth momentum in core fee income to continue led by cross-sell opportunities and increasing distribution reach. Increase in CASA deposits from expansion in retail business is likely to enhance cross-sell opportunities. We forecast 16.5% CAGR growth in other income over FY18-20E.

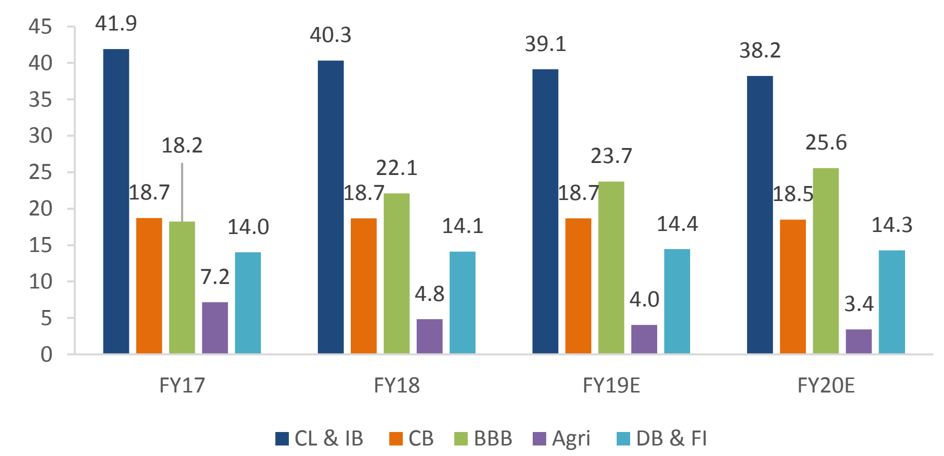
Company Overview

RBL Bank is one of India's fastest growing private sector banks with a loan growth of 40.7% CAGR over FY15-18, and presence across the country. For Q1FY19, its segment wise loan mix is, Corporate & Institutional Banking (40.6%), Commercial Banking (18.6%), Branch & Business Banking (~21.9%), Agribusiness Banking (~5%), Development

Banking and Financial Inclusion (~13.9%). It currently services over 45 lakh customers through a network of 462 branches (including banking outlets) and 388 ATMs spread across 20 Indian states and Union Territories. For Q1FY19, its loan mix was ~59% wholesale and ~41% non-wholesale. For Q1FY19, RBL Bank's loan book stood at ~₹42,198cr; GNPA was at 1.4%; NNPA was at 0.75%; net interest margin was 4.04%, capital adequacy ratio at 14.6%, cost-to-income ratio at 50.8% and PCR at 60.4%.

The proportion of higher yielding assets from retail in the entire asset mix is further expected to improve from ~22% in FY18 to ~26% in FY20E

Exhibit 3: Loan Mix (%)



Source: Company, IIFL Research

Exhibit 4: Sector-wise top 10 industry exposures

Industry	% of Exposure Q1FY19
Construction	6
Engineering	5
Trade/ Distribution	4.8
Power	3.9
Professional Services	3.7
Pharma	3.6
Real Estate	3.4
Metals	3.3
Financial Services	2.3
Logistics	1.9

Source: Company

Key Risks

- If the bank's asset quality deteriorates significantly, profitability would be impacted.
- If the PSU banks capital position increases significantly then, it could affect the bank's advances growth and profitability.

Premia Research

Karur Vysya Bank Ltd

CMP: ₹94; 1-year target: ₹116

Sector	Banking
Recommendation	BUY
Upside	23%

Stock Data

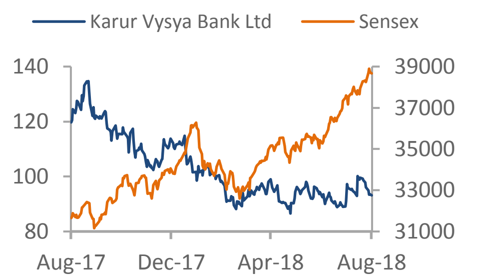
Sensex	38,690
52 Week h/l (₹)	150/94
Market cap (₹ Cr)	7,609
BSE code	590003
NSE code	KARURVYSYA
FV (₹)	2
Div yield (%)	0.57

Shareholding Pattern

	Dec-17	Mar-18	Jun-18
Promoters	2.08	2.08	2.08
DII+FII	39.61	40.18	40.10
Individuals	58.30	57.73	57.82

Source: ACE Equity, IIFL Research

Share Price Trend



Prices as on 30/08/2018

Karur Vysya Bank Ltd (KVB; south India based bank) to benefit from its digital banking initiative, asset quality improvement and advances growth. Further, improving loan mix, higher CASA, lower cost ratios to also support its return profile. We forecast its RoA & RoE to increase by 48bps and 540bps to 1% and 11.5% respectively over FY18-20E. KVB is currently trading at ~1.5x FY20E P/ABV, which is attractive from a risk-reward point of view. Considering the multiple levers, we value the bank at 1.8x FY20E P/ABV, to arrive at the 12-month target price of ₹116.

Improving asset quality to drive return ratios

We believe the bank is in its tail end in terms of corporate NPAs. Out of the ~₹1,200cr of watch list in Q2FY18, it has reduced to ~₹170cr in Q1FY19 (already provided for in previous quarters). Corporate GNPA for FY18 stood at 74% of the total GNPA. Post this, the bank is expected to return to normalcy in terms of slippages (~₹750cr normalized slippages) and credit costs (~1.5%), which in turn would drive its return ratios. We expect the GNPA ratio to decline by 136bps to 5.2% over FY18-20E, due to lower slippages and higher recoveries due to resolution in NCLT cases. The bank expects majority of the NCLT exposures to be resolved in FY19E. Over FY18-20E, lower loan loss provisions/interest reversal due to lesser slippages to drive an improvement in RoA. We expect its RoA & RoE to increase by 51bps and 586bps respectively over FY18-20E.

Outlook & Valuation: Reduction in stressed asset formation and improvement in core profitability would drive the re-rating of stock. We forecast its revenue and profit to register 14.1% and 50.9% CAGR over FY18-20E respectively.

Financial Summary

Figures in ₹ Cr	FY17	FY18	FY19E	FY20E
Net interest income	2,074	2,298	2,665	2,974
Total net operating income	2,856	3,198	3,699	4,164
Pre-provision profit	1,571	1,777	1,887	2,332
Net profit	606	346	456	787
P/E (x)	10.4	21.7	16.4	9.5
P/ABV (x)	1.6	1.7	1.7	1.5
ROE (%)	12.0	6.1	7.1	11.6
ROA (%)	1.0	0.5	0.6	1.0

Source: Company, IIFL Research

We expect its RoA & RoE to increase by 51bps and 586bps respectively over FY18-20E

Balance Sheet

Figures ₹ Cr	FY17	FY18	FY19E	FY20E
Sources of funds				
Share Capital	134	160	160	160
Total Reserves	4,901	6,105	6,363	6,897
Net worth	5,035	6,264	6,522	7,056
Deposits	53,700	56,890	63,603	71,108
Borrowings	1,696	2,382	2,453	2,527
Other Liabilities & Provisions	1,376	1,393	1,393	1,393
Total Liabilities	**61,807**	**66,929**	**73,972**	**82,085**
Application Of Funds				
Cash balance with RBI	2,790	2,960	3,923	3,170
Balances with banks	1,555	1,337	1,337	1,337
Investments	14,857	15,803	16,435	17,093
Advances	40,908	44,800	50,028	58,009
Gross block	419	528	628	728
Net Block	419	528	628	728
Other Assets	1,279	1,501	1,651	1,816
Total Assets	**61,807**	**66,929**	**73,972**	**82,085**

Source: Company, IIFL Research

Key Ratios

	FY17	FY18	FY19E	FY20E
Margins (%)				
NIM	3.7	3.9	3.9	3.9
Interest Spread	3.1	3.2	3.3	3.2
Profitability (%)				
Cost to Income	45.0	44.4	49.0	44.0
CD Ratio	76.2	78.7	78.7	81.6
CASA	27.7	29.1	30.7	32.3
Assets Quality (%)				
Gross NPA	3.6	6.6	6.2	5.2
Net NPA	2.5	4.2	3.8	3.2
Provision Coverage	57.8	56.5	58.0	58.0
Capital Adequacy (%)				
CAR	12.5	14.4	14	13.4

Source: Company, IIFL Research

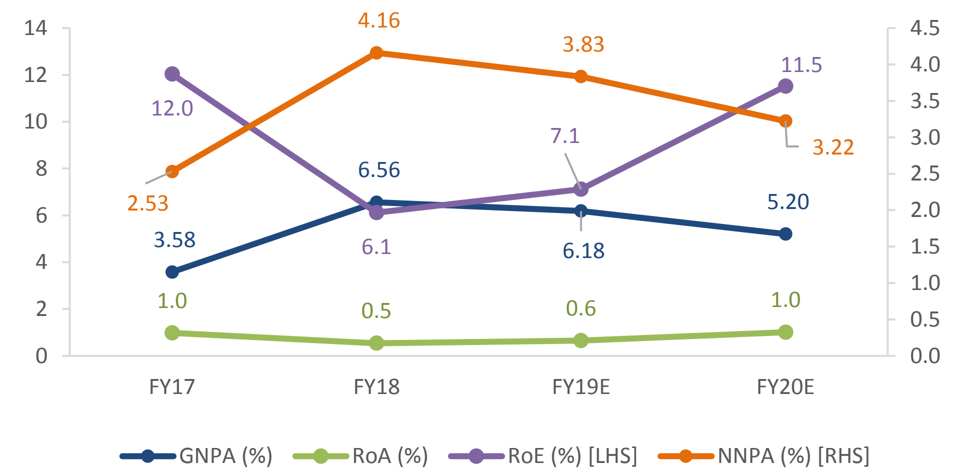
DuPont Analysis

Y/E March	FY17	FY18	FY19E	FY20E
NII / Assets (%)	3.4	3.5	3.7	3.7
Other Income / Assets (%)	1.3	1.4	1.4	1.5
Total Income / Assets (%)	4.8	4.9	5.2	5.2
Cost / Assets (%)	2.1	2.2	2.5	2.3
PPOP / Assets (%)	2.6	2.7	2.6	2.9
Provisions / Assets (%)	1.1	2.0	1.7	1.5
PBT / Assets (%)	1.5	0.8	0.9	1.4
Tax rate (%)	31	31	31	31
ROA (%)	1.0	0.5	0.6	1.0
Leverage (x)	11.9	10.4	11.0	11.3
RoE (%)	12.0	5.5	7.0	11.2

Source: Company, IIFL Research

The GNPA ratio is expected to decline by 136bps to 5.2% over FY18-20E due to lower slippages, higher recoveries

Exhibit 1: Asset quality improvement to drive return ratios



Source: Company, IIFL Research

The bank's strategy is to increase the more granular retail/SME portion and restrict large-ticket corporate exposures to lower corporate slippages. The management has guided that most of the heavy lifting in terms of recognition of lumpy corporate accounts has been over by Q1FY19 and that remainder of the year should see normalized slippages and credit costs (of 1.5%). Normalization of slippage rate and credit cost due to efficient risk management practices, better recovery and lesser focus on corporate segment to reduce provisioning requirement, and hence would drive its return ratios going ahead. Notably, the bank's provisioning in FY18 had increased by ~85% yoy.

Digital transformation an enabler of next leg of growth

We expect the bank's loan book to grow at 14.2% CAGR over FY18-20E

KVB has migrated to the latest version of "Flexcube'' Core Banking platform. This is amongst the first in the industry. This enables a highly automated underwriting process that relies on third party data (Credit Bureaus, Banking Data and Tax related data amongst others). It enables credit decisions to be taken in minutes as against in days, while tightly managing credit risk with the help of credit scores. During Q4FY18, the bank launched two new digital products i.e. algorithmically underwritten home loans (1st in the industry) and working capital renewal products. One of the core objectives of going digital has been to quantify risk and improve the ability to underwrite loans (presently old method of underwriting), which will help to have good quality assets on the book. As the new systems comes in place, it will be able to grow business much more quickly. In H2FY19 it will be launching all its products and services on a completely digital platform, which will boost the loan book of the bank. We expect the bank's loan book to grow at 14.2% CAGR over FY18-20E, that will also aid in garnering low cost deposits. Expected higher share coming from CASA owing to digitization will have a positive impact on the NIMs.

Exhibit 2: Digitalization initiative of the bank

Source: Company

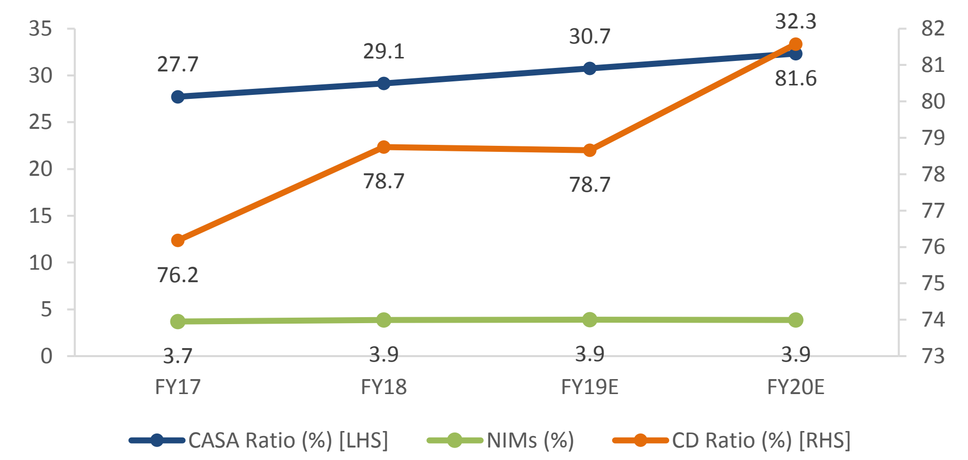
Change in loan mix, improving CASA & CD ratio to support NIMs

We expect its CASA ratio to improve by 320bps to 32.3% over FY18-20E

The bank is focusing on Retail, Commercial and Agri segments (and has decided to show moderate growth in Corporate segment). The bank's new scored model technology initiative will update the relative riskiness of the clients, which in turn will restrict the slippages, so there is a scope for improvement in spreads and NIMs. Further, it will aid the bank to garner low cost deposit. We expect its CASA ratio to improve by 320bps to 32.3% over FY18-20E. As the banks loan growth increases, its CD ratio is likely to improve by 414bps to 82.9% over FY18-20E. The NIMs to remain steady over FY18-20E due to (1) change in mix towards higher yielding segments like Commercial & Retail, (2) lower interest reversals due to lower slippages and (3) declining cost of funds.

Exhibit 3: Rising CASA & CD ratio to drive NIM expansion

Change in mix towards higher yielding segments like Commercial & Retail, lower slippages and declining cost of funds to aid NIM expansion in addition to expanding CASA and CD ratio



Source: Company, IIFL Research

Change in mix towards higher yielding segments like Commercial & Retail, lower interest reversals due to lower slippages and declining cost of funds to also aid NIM expansion in addition to expanding CASA and CD ratio.

The bank's strategy is to increase retail/SME portion and restrict large-ticket corporate exposures

Company Overview

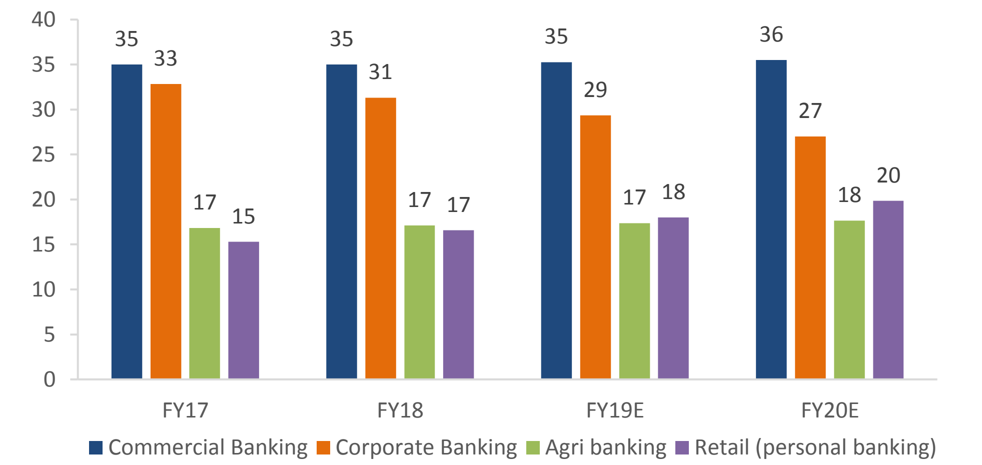
Karur Vysya Bank is a South India based bank with large geographic concentration in Tamil Nadu and Andhra Pradesh. Its current market share in loans and deposits is ~0.6% each as of March 31, 2018. The loan mix for Q1FY19 is diversified, corporate/commercial/Agriculture and retail formed 31%/35%/17% and 17% of its loan book. For Q1FY19 end, the bank's loan book stood at ~₹0.48 lakh cr; GNPA was at 7.44%;

Its current market share in loans and deposits is ~0.6% each as of March 31, 2018

NNPA was at 4.5%; net interest margin was 3.65%; PCR at 56.5%; capital adequacy ratio was at 14.08%; cost-to-income ratio at 45.18%. For Q1FY19, the CASA and term deposit ratio stood at 30% and 70% respectively.

We expect the bank's loan book to grow at 14.2% CAGR over FY18-20E

Exhibit 4: Loan Mix (%)



Source: Company, IIFL Research

The size of the corporate book is expected to come down to ~25% in next 4 years from 31% in FY18, as other areas like retail and SME would grow at a faster pace.

Exhibit 5: Sector-wise industry exposures

Advances – Sector Details	% of Total Advances (Q1FY19)
Manufacturing sector	28
Trading	17
Jewel loan	15
Personal loans	13
Agri	4
CRE	6
Bills	3
NBFC	3
Others	11

Source: Company

Key Risks

- If the bank's asset quality deteriorates significantly, profitability would be impacted.
- If the PSU banks capital position increases significantly then, it could affect the bank's advances growth and profitability.

IIFL Premia Research

City Union Bank Ltd

CMP: ₹ 203; 1-year target: ₹ 235

Sector	Banking
Recommendation	BUY
Upside	16.1%

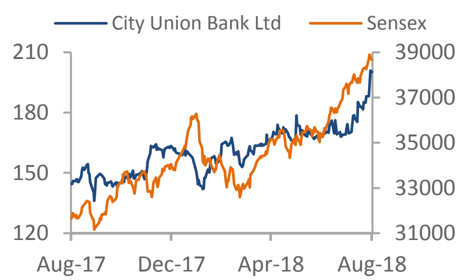
Stock Data	
Sensex	38,690
52 Week h/l (₹)	185/133
Market cap (₹ Cr)	14,843
BSE code	532210
NSE code	CUB
FV (₹)	1
Div yield (%)	0.18

Shareholding Pattern

	Dec-17	Mar-18	Jun-18
Promoters	0.0	0.0	0.0
DII+FII	50.55	50.8	51.28
Individuals	49.45	49.2	48.72

Source: ACE Equity, IIFL Research

Share Price Trend



Prices as on 30/08/2018

City Union Bank Ltd (CUB; south India based bank) to benefit from its increasing loan book led by better traction in MSME and retail loan book segments. Its focus on lower slippages and higher recovery will lead to declining credit cost over next couple of years. In addition, focus on high yielding products, higher CASA & CD ratio and lower cost ratios to also support its return profile. We forecast its RoA & RoE to increase by 7bps and 13bps to 1.64% and 15.4% respectively over FY18-20E. Considering multiple levers, we assign 2.8x on FY20E P/ABV to arrive at target price of ₹235.

Retail & MSME to drive loan book growth

We expect high double digit growth in loan book over FY18-20E, largely driven by MSME and the retail book and a better credit environment in Tamil Nadu. Its capital position is also sufficient at ~16.2% capital adequacy (tier-1 15.8%) for FY18. The bank is expected to register 17.7% loan book growth over FY18-20E as a result of the management's focus on MSME and retail segments. As of FY18 end, it had 600 branches and it plans to add 50-75 branches in FY19, which will also aid loan book growth.

Outlook & Valuation: With its stable asset quality, better capital position and focused SME & retail lending strategy, we expect profitability and margins to be strong over FY18-20E. We forecast 16.4% earnings CAGR over FY18-20E. The bank has higher return profile, with RoA & RoE at ~1.6% and 15.3% for FY18. Further, its secured lending model in the form of small ticket size loans (mostly working capital loans) provides cushion to asset quality. It has also been able to improve its NIMs led by its focus on higher yielding loans.

Financial Summary

Figures in ₹ Cr	FY17	FY18	FY19E	FY20E
Net interest income	1,199	1,430	1,589	1,882
Total net operating income	1,683	1,962	2,174	2,531
Pre-provision profit	994	1,208	1,337	1,557
Net profit	503	592	666	802
P/E (x)	24.2	22.8	20.2	16.8
P/ABV (x)	3.5	3.3	2.9	2.5
ROE (%)	15.3	15.3	14.9	15.4
ROA (%)	1.4	1.6	1.6	1.6

Source: Company, IIFL Research

Balance Sheet

Figures ₹ Cr	FY17	FY18	FY19E	FY20E
Sources of funds				
Share Capital	60	66	66	66
Total Reserves	3,510	4,097	4740	5520
Networth	3,570	4,163	4,807	5,586
Minority interest				
Deposits	30,116	32,853	37781	43448
Borrowings	531	1,736	1753	1806
Other Liabilities & Provisions	1,054	1,186	1,304	1,434
Total Liabilities	**35,271**	**39,937**	**45,645**	**52,274**
Application Of Funds				
Cash with RBI	1,484	1,862	2,034	2,289
Balances with banks	1,395	775	813	854
Investments	7,031	7,879	8431	9021
Advances	23,833	27,853	32619	38160
Net Block	215	223	268	321
Other Assets	1,313	1,346	1,480	1,628
Total Assets	**35,271**	**39,937**	**45,645**	**52,274**

Source: Company, IIFL Research

Key Ratios

We forecast RoA & RoE to increase by 7bps and 13bps to 1.65% and 15.4% respectively over FY18-20E

	FY17	FY18	FY19E	FY20E
Margins (%)				
NIM	4.2	4.4	4.3	4.4
Interest Spread	3.6	3.9	3.5	3.6
Profitability (%)				
Cost to Income	40.9	38.5	38.5	38.5
CD Ratio	79.1	84.8	86.3	87.8
CASA	22.0	28.0	30.0	32.0
Assets Quality (%)				
Gross NPA	1.2	3.0	2.8	2.3
Net NPAs	0.6	1.7	1.5	1.1
Provision Coverage	61	64	66	67
Capital Adequacy (%)				
CAR	15.8	16.2	15.9	15.5

Source: Company, IIFL Research

We forecast RoA & RoE to increase by 7bps and 13bps to 1.65% and 15.4% respectively over FY18-20E

DuPont Analysis

Y/E March	FY17	FY18	FY19E	FY20E
NII / Assets (%)	3.6	3.7	3.6	3.7
Other Income / Assets (%)	1.4	1.4	1.3	1.3
Total Income / Assets (%)	5.0	5.1	5.0	5.0
Cost / Assets (%)	2.0	2.0	1.9	1.9
PPOP / Assets (%)	2.9	3.1	3.0	3.1
Provisions / Assets (%)	0.9	1.1	1.0	0.9
PBT / Assets (%)	2.1	2.1	2.1	2.2
Tax rate (%)	27.4	25.1	27.0	27.0
ROA (%)	1.5	1.5	1.5	1.6
Leverage (x)	9.5	9.2	9.1	9.0
ROE (%)	14.1	14.2	13.9	14.4

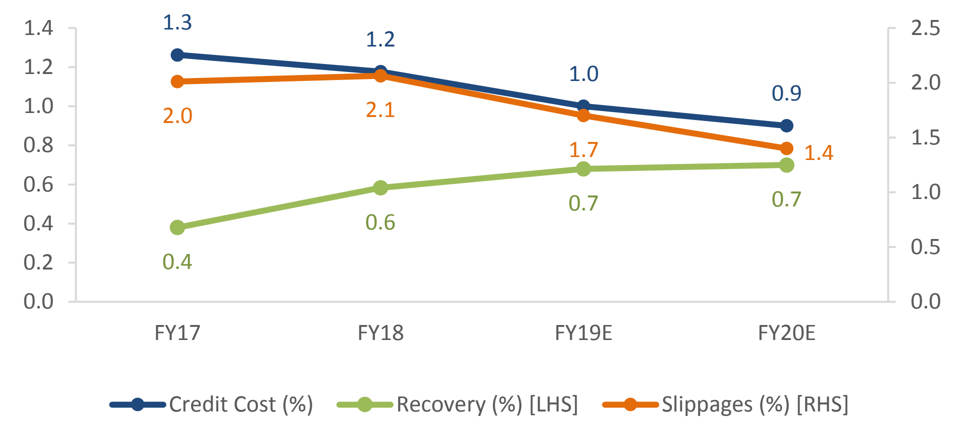
Source: Company, IIFL Research

Credit cost to decline with focus on lower slippages and recovery

We expect bank's GNPA and credit cost to decline by 72bps and 28bps to 2.3% and 0.9% respectively over FY18-20E

The bank's focus on small-ticket secured lending (99% of loan portfolio secured) has helped to maintain sound asset quality in the past few years. The bank specializes in small-ticket SME loans (~₹25 lakh-₹1cr). Of its total loan book, ~66% comprises working capital loans, which are completely collateralized with immovable properties. The lower ticket size lending, which are backed by adequate collaterals, restrict the slippages of NPA and also improve the NPA recoveries. The bank's focus is on controlling the slippage and also improving the recovery of NPAs by liquidation of collaterals. With slippages normalizing and recoveries gaining traction, we expect a gradual decline in stressed assets. The bank has largely classified most of the riskier exposures as NPA and there are very few such exposures remaining. We expect GNPA and credit cost to decline by 72bps and 28bps to 2.3% and 0.9% respectively over FY18-20E.

Exhibit 1: Lower slippages & better recovery to aid low credit cost



Source: Company, IIFL Research

The bank's focus is on controlling the slippage and also improving the recovery of NPAs by liquidation of collaterals, which will lead to lower credit cost.

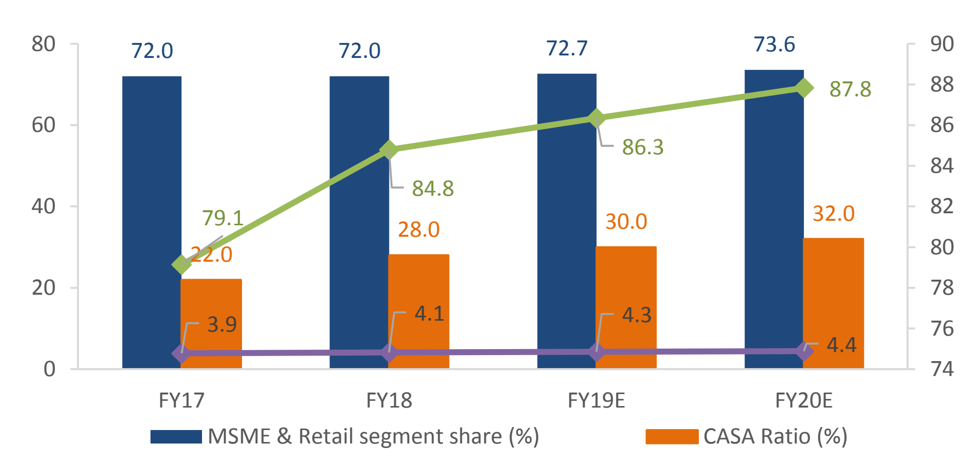
High yielding loans and better CD ratio to drive NIMs improvement

We expect the bank's NIM to improve by 33bps to 4.4% through FY18-20E

The main focus of the bank is on high yielding segments like MSME and Retail (together formed 72% for FY18). We expect the proportion of both the segments to go up to 73.6% of total advances by FY20E. Its Credit Deposit (CD) ratio has also improved by 652bps to 84.8% over FY16-18 and we expect it to further improve by 305bps to 87.8%. Also, its share of CASA in total deposits is likely to go up by 400bps to 32% over FY18-20E. The increasing CASA proportion in total deposits will lead to decline in cost of deposits, which we forecast would fall by 43bps to ~5.9% over FY18-20E. We expect the bank's NIM to improve by 33bps to 4.4% through FY18-20E.

Its share of CASA in total deposits is likely to go up by 400bps to 32% over FY18-20E.

Exhibit 2: Change in product mix & rising CASA to support NIMs



Source: Company, IIFL Research

Despite the yields to see pressure over the next couple of years, we expect NIMs improvement due to continued focus on higher yield products and expanding CASA share in total deposits.

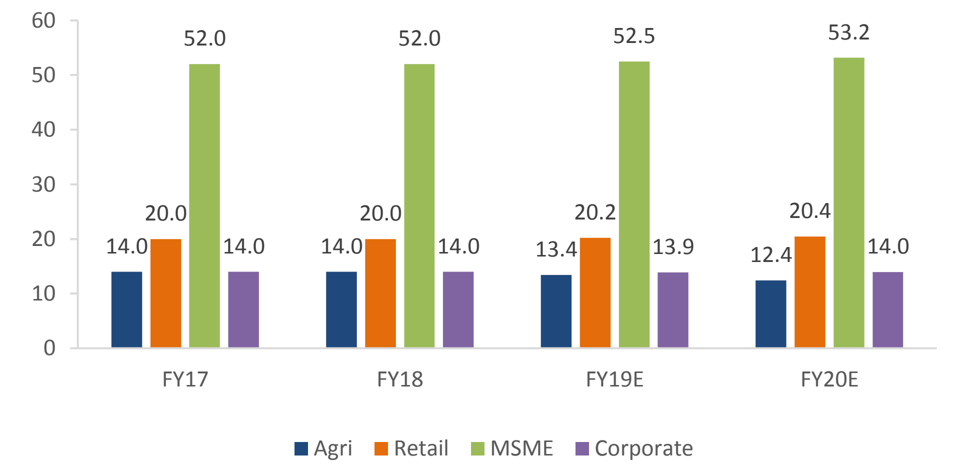
Company Overview

City Union Bank has delivered ~1.5% ROA consistently over the last several years.

City Union Bank is a small-sized regional bank based out of Kumbakonam, Tamil Nadu with a legacy of over 100 years. It had a network of 600 branches as of FY18 end and 538 branches are located in South India out of which 415 are in Tamil Nadu. It is primarily a working capital lender to MSME, retail/wholesale trade and agricultural sectors. Its operations are mostly concentrated in Tamil Nadu, followed by Andhra Pradesh and Telangana. CUBK has a high yielding portfolio, strong SME relationships, well-managed asset quality, and it has delivered ~1.5% ROA consistently over the last several years. For Q1FY19, its loan book stood at ~₹0.28 lakh cr, GNPA was at 3.02%; NNPA was at 1.7%; net interest margin was 4.24% and capital adequacy ratio was at 16.06%, cost-to-income ratio stood at 40.58%.

The bank is expected to register 17.7% loan book growth over FY18-20E, as a result of management focus on MSME and retail segments

Exhibit 3: Loan Mix (%)



Source: Company, IIFL Research

Exhibit 4: % of total Advances to major industries vs other sectors

Industry	₹ cr.	% of Total Advances
Advances to major industries	6,828	24
All other advances (Agri, Trade, Service, Gold Loan, etc.)	21,387	76

Source: Company

Exhibit 5: Advances to major industries as of Q1FY19

Sectors	Exposure (%)
Textile	
Cotton	5
Other Textiles	6
Metals	
Iron & Steel	3
Other Metals	1
Paper & Paper Products	2
Food Processing	1
Chemicals	1
Rubber & Plastics	1
Engineering	2
Automobiles	1
Other Industries	1

Source: Company

Key Risks:

- If the bank's slippages rises significantly, profitability would be impacted.
- If the PSU banks capital position increases significantly then, it could affect the bank's advances growth and profitability.

Disclaimer

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%
Accumulate – Absolute return between 0% to +10%
Reduce – Absolute return between 0% to -10%
Sell – Absolute return below -10%

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