November 22, 2021

City Union Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating^	-	-	[ICRA]AA-(Stable); reaffirmed
Certificates of Deposit	25.00	25.00	[ICRA]A1+; reaffirmed
Total	**25.00**	**25.00**	

**Instrument details are provided in Annexure-1*

^ Issuer rating is an opinion on the general creditworthiness of the rated issuer and is not specific to any particular debt instrument

Rationale

The ratings reaffirmation considers City Union Bank Limited's (CUB) established retail franchise, resulting in a granular asset and liability base, its strong capitalisation profile (CET I ratio of 18.18% as on September 30, 2021), strong liquidity profile and healthy profitability indicators with return ratios above the private banks' (PVBs) average. Despite being granular, the cost of interest-bearing funds for the bank remains marginally higher than the PVB average because of the relatively low share of current account and savings account (CASA) deposits in total deposits, even though CASA remains comparable to peers.

The ratings remain constrained by the increasing asset quality pressure indicated by the increasing stressed loans {overdue loan accounts, i.e. SMA[1]-1 and 2 advances, standard restructured advances and net non-performing advances (NNPAs)}. The bank's ability to reduce the stressed loan book will be critical for sustaining its profitability and capital ratios. The ratings are also constrained by the high regional concentration of CUB's operations as well as the high share of the top 20 depositors in the total deposits compared to peer banks.

The Stable outlook on the rating reflects our expectation that the bank will continue to maintain a granular asset and liability profile, which will support its liquidity profile. Moreover, we expect that CUB will be able to ride out the asset quality stress with support from its operating profits while maintaining a strong capital position and solvency[2] profile and keeping the same above our negative triggers.

Key rating drivers and their description

Credit strengths

Established retail franchise resulting in granular asset and liability base – CUB has an established retail franchise with more than 100 years of operations in South India. Around 90% of its total branches (702) were in South India (69% in Tamil Nadu) as on September 30, 2021. The bank has a granular asset profile with the top 20 exposures accounting for 38.4% of the Tier I capital as on March 31, 2021, down from 40.6% as on March 31, 2020 on account of internal accruals; it remains the lowest among peers. CUB has a strong retail deposits franchise with limited dependence on bulk deposits. In terms of granularity of deposits, deposits over Rs. 2 crore were less than 10% of the total deposits as on March 31, 2021.

Despite limited dependence on bulk deposits, the bank's cost of average interest-bearing funds remained high at 4.64% in H1 FY2022 (5.17% in FY2021) compared to the PVBs' average (4.48% in FY2021) on account of the relatively lower share of CASA

[1] SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as an NPA as per the extant RBI guidelines; SMA-1 accounts are overdue by 31-60 days while SMA-2 accounts are overdue by 61-90 days. The SMA-level data is for the entire bank including exposures below Rs. 5 crore

[2] Solvency defined as (Net non-performing advances + Net security receipts + Net non-performing investments) / Core capital)

deposits in the overall deposit base. Although CUB's CASA ratio increased to 28.96% as on September 30, 2021 from 25.70% as on September 30, 2020, it remains comparable with peers.

Healthy profitability indicators, though contingent upon sustaining the asset quality – CUB's net interest margins (NIMs) remained strong at 3.37% in H1 FY2022 (3.55% in FY2021), comparable to the PVBs' average (3.61% in FY2021) despite the relatively higher funding cost in relation to the PVBs' average and the excess liquidity carried by the bank. The NIMs are supported by the granular nature of the loan book to micro, small and medium enterprises (MSMEs), but have come down from past levels mainly on account of the increase in the relatively low-yielding jewel loans. The share of jewel loans increased to 21% of gross advances as on September 30, 2021 from 18% as on March 31, 2021. In addition, the customer profile and limited ability to cross-sell other products result in lower core fee income and core operating profitability compared to the PVBs' average (2.43% of average total assets (ATA) for CUB vs 2.71% for PVBs in FY2021).

Supported by the hefty gains on the bond portfolio and various regulatory support measures including loan restructuring to support the asset quality during the Covid-19 pandemic, CUB was able to report a healthy return on assets (RoA) and return on equity (RoE) of 1.15% and 10.15%, respectively, in FY2021, similar to the PVBs' average. Considering the expected moderation in gains on the bond portfolio, the bank's ability to reduce the stressed book would remain critical for its overall profitability.

Strong capitalisation level supported by steady internal accruals – CUB's capitalisation profile remains strong with a core equity or CET I/Tier I capital ratio of 18.18% as on September 30, 2021 compared to the regulatory requirement of 9.5%. The improvement in the capital ratios was supported by healthy internal accruals and reduction in risk-weighted assets (RWAs) because of incremental loan disbursements under the Government-guaranteed Emergency Credit Line Guarantee Scheme (ECLGS) and jewel loans, which attract zero risk weight. The bank last raised equity capital of Rs. 350 crore in FY2015 and its internal capital generation has been adequate since then to meet the credit growth. While its capital requirement remains negligible in the near term, CUB has a board-approved equity capital-raising plan of Rs. 500 crore. We believe that the strong capital position will act as a good cushion against the expected slippages from the stressed book over the near to medium term.

Credit challenges

Increase in overall stressed assets; strong capital position and healthy operating profitability likely to help absorb asset quality shocks – Despite various regulatory relief measures announced for borrowers such as a moratorium on debt servicing, the restructuring of gross slippages remained elevated at 3.36% of standard advances in FY2021. CUB's borrower segment, which predominantly includes the self-employed segment, small businesses and MSMEs, was severely impacted by the pandemic. The second wave of Covid-19 in Q1 FY2022 further added pressure to the cash flows of borrowers and slippages remained elevated at Rs. 780 crore or 4.4% of standard advances in H1 FY2022. The bank had a standard restructured book of Rs. 2,248 crore (6.26% of standard advances) as on September 30, 2021, which is one of the highest in the sector. Despite the high slippages and the restructured book, its SMA-1 and SMA-2 accounts stood high at 6% of the standard advances as on September 30, 2021 though the same declined from past levels (8.38% as on March 31, 2019).

Overall, including the net NPAs, the stressed assets remained high at 15.4% of advances (~105% of core capital) as on September 30, 2021. ICRA also notes that the granular and secured nature of advances results in high recovery levels from NPAs and is a potential mitigant against a final loss. The bank had ~Rs. 48 crore of Covid provisions (0.13% of standard advances) as on September 30, 2021 apart from 7.4% of provisions on the restructured loan book that can be utilised against incremental stress. ICRA expects that the bank's healthy operating profitability and strong capital position will help it absorb the asset quality pressure in the coming years while maintaining a strong capital profile.

Geographically concentrated operations; unlikely to improve in the medium term – The bank's operations remain geographically concentrated with ~90% of its total branches (702) located in South India and 69% in Tamil Nadu as on September 30, 2021. This resulted in concentration of advances and deposits with 86% of the advances and 93% of the deposits accruing from South India (66% and 81%, respectively, from Tamil Nadu) as on September 30, 2021. Moreover, the share of the top 20 deposits in the bank's total deposits remained the highest among peers at 10.62% as on March 31, 2021. Such concentration exposes the bank's assets and liabilities to local socio-economic and political risks. ICRA expects the bank's operations to remain regionally concentrated with the same unlikely to improve in the medium term.

Liquidity position: Strong

CUB's liquidity profile remains strong with positive cumulative mismatches in the maturity bucket of up to one year. The liquidity coverage ratio (LCR) was comfortable at 271% in Q4 FY2022 (234% in Q4 FY2020), driven by the excess statutory liquidity ratio (SLR) holding of Rs. 2,737 crore or 5.9% of net demand and time liabilities (NDTL) as on August 27, 2021 coupled with the low level of non-operational deposits and less stable deposits in total deposits.

CUB's ability to maintain a strong liquidity profile will continue to be driven by the high rollover of term deposits. In addition, access to call money markets and the Reserve Bank of India's (RBI) repo and marginal standing facility (MSF) in case of urgent liquidity needs aid CUB's liquidity profile.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the rating if the bank increases its geographical diversification of the asset and liability base outside Tamil Nadu, while improving its asset quality and profitability.

Negative factors – ICRA could revise the outlook to Negative or downgrade the ratings if there is a weakening in the solvency profile with the solvency remaining weaker than 25% or if the cushion over the regulatory Tier I capital adequacy falls below 3% on a sustained basis. Further, the inability to internally generate growth capital (RoA below 1.0%) or a deterioration in the liability franchise will be negative triggers.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of CUB

About the company

Incorporated as The Kumbakonam Bank Limited in 1904, CUB is one of the oldest private sector banks, with its headquarters in Kumbakonam, Tamil Nadu. As on September 30, 2021, it had a network of 702 branches and 1,720 ATMs with about 90% of the total branches being in South India. About 57% of the branches are in semi-urban and rural areas. CUB reported a capital adequacy ratio of 19.24% (Tier I: 18.18%) and gross and net NPAs of 5.58% and 3.48%, respectively, as of September 30, 2021. In H1 FY2022, the bank reported a net profit of Rs. 355 crore on an asset base of Rs. 56,463 crore compared to a net profit of Rs. 312 crore on an asset base of Rs. 50,583 crore in H1 FY2021.

Key financial indicators (audited)

City Union Bank Limited	FY2020	FY2021	H1 FY2021	H1 FY2022
Net interest income	1,675	1,830	912	926
Profit before tax	586	693	407	470
Profit after tax	476	593	312	355
Net advances	33,927	36,158	34,825	37,131
Total assets	49,734	53,312	50,583	56,434
% CET I/Tier I	15.81%	18.45%	16.29%	18.18%
% CRAR	16.76%	19.52%	17.36%	19.24%
% Net interest margin	3.53%	3.55%	3.64%	3.37%
% PAT / ATA	1.00%	1.15%	1.24%	1.29%
% Return on net worth	8.99%	10.15%	11.47%	11.80%
% Gross NPAs	4.09%	5.12%	3.45%	5.58%
% Net NPAs	2.29%	2.97%	1.81%	3.48%
% Provision coverage excl. technical write-offs	44.92%	43.21%	48.27%	38.92%
% Solvency	17.7%	20.4%	33.04%	24.36%

***Note:** Amount in Rs. crore; All calculations are as per ICRA Research*
Total assets and net worth exclude revaluation reserves
***Source:** CUB, ICRA Research*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years			
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Nov-22-2021	Nov-30-2020	Oct-31-2019	Sep-11-2018	Aug-31-2018
1	Issuer Rating	Long Term	-	-	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	-
2	Certificates of Deposit	Short Term	25	0	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

Complexity level of the rated instrument

Instrument	Complexity Indicator
Issuer Rating	NA
Certificates of Deposit	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Issuer Rating	NA	NA	NA	NA	[ICRA]AA-(Stable)
-	Certificates of Deposit*	NA	NA	7-365 days	25.00	[ICRA]A1+

Source: *CUB; *- CD outstanding is NIL as on November 16, 2021*

Annexure-2: List of entities considered for consolidated analysis

Company name	Ownership	Consolidation approach
NA	NA	NA

Source: *CUB*

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Aayush Behal
+91 124 4545 300
aayush.behal@icraindia.com

Hemant Sultania
+91 124 4545 386
hemant.sultania@icraindia.com

RELATIONSHIP CONTACT

Mr. Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches