

City Union Bank Limited

September 11, 2018

Summary of rated instruments

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

* Instrument details are provided in the Annexure-1

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

Rating action

ICRA has assigned the issuer rating of [ICRA]AA- (pronounced ICRA double A minus) to City Union Bank Limited (CUB). The outlook on the long-term rating is Stable. ICRA has [ICRA]A1+ (pronounced ICRA A one plus) rating outstanding on the Rs. 25.00-crore certificates of deposit programme of CUB.

Rationale

The assigned rating factors in CUB's established regional franchise in Tamil Nadu (TN), its adequate capitalisation (CET I ratio of 15.6% in June 2018) and liquidity profile (LCR¹ of 143% in March 2018) as well as its good profitability indicators (return on assets (RoA) at 1.6% for FY2018). The rating also factors in the bank's modest scale, geographically concentrated nature of operations (64% of advances and 79% of deposits are in TN) and its moderate deposit profile (CASA at 23.9% as on June 30, 2018). ICRA notes that CUB's established regional franchise in TN provides it with access to core retail deposits (share of deposits below Rs. 1 crore accounted for 81% of the total term deposits as on March 31, 2018). ICRA also takes note of the bank's moderate asset quality indicators with gross NPA of 3.0%, provision cover² of ~44.4% and SMA-2 (as a percentage of total advances) of about 3% in June 2018 (~4% in March 2018).

Going forward, CUB's ability to maintain a healthy overall financial risk profile and keep its asset quality under control as the business grows would be crucial from a rating perspective.

Outlook: Stable

The Stable outlook factors in the bank's comfortable financial risk profile characterised by adequate capitalisation, good profitability and a comfortable liquidity position, as well as its established track record of operations. The outlook may be revised to Positive if the bank steadily improves its deposit profile and scale while maintaining a tight control over the asset quality. The outlook may be revised to Negative if there is a significant deterioration in its asset quality, earnings profile or capitalisation levels.

¹ LCR - Liquidity coverage ratio

² (Gross NPA- Net NPA)/Gross NPA

Key rating drivers

Credit strengths

Established regional franchise - CUB's established regional franchise in TN provides it with access to core retail deposits. The retail term deposits (below Rs. 1 crore) accounted for about 81% of the total term deposits as of March 2018. The bank had 600 branches with TN accounting for 69% of the branches, 63% of the advances and 78% of the deposits on the above-mentioned date.

Good profitability indicators – CUB's net interest margin (NIM) remained healthy (3.8% in FY2018 and 3.6% in FY2017) supported by the high yielding and granular nature of its exposures although funding costs were higher compared to its peers. Almost 52% of the bank's exposure was towards the MSME and trading segments and ~73% of the total advances (in March 2018) had a ticket size of less than Rs. 5.0 crore (16% with ticket size of more than Rs. 10 crore), with higher yields compared to larger corporates or prime retail exposures. Further, close to 66% of CUB's advances were in the form of working capital facilities, where the yields are better. The bank's operating costs have remained stable at about 2.0% over the last three years and its credit costs have remained at about 0.8% during this period. CUB's non-interest income (excluding trading profits) has also remained largely stable at about 1.1-1.2% over the last three years. Healthy NIMs along with stable operating and credit costs have helped the company report a stable RoA of 1.5-1.6% over the last three-year period.

Adequate capitalisation and liquidity profile - CUB's capital levels are adequate, supported by good internal generation³ (15% over the last three years). The bank received equity infusion of Rs. 350 crore in FY2015 via the QIP route. Its overall capital adequacy under Basel III was comfortable at 16.1% (CET I ratio at 15.6%) as on June 30, 2018. CUB's current capital levels are likely to support its envisaged growth over the medium term without any sizeable capital requirement. Its solvency ratio (net NPAs/net worth) was comfortable of 10.9% as on June 30, 2018 and was better than the private sector banks' average. CUB's liquidity profile is comfortable with a liquidity coverage ratio of about 143% as of March 2018.

Credit challenges

Modest scale and geographically concentrated operations – CUB's advances and deposits stood at Rs. 28,215 crore and Rs. 33,597 crore, respectively, in June 2018 accounting for about 0.34% and 0.30%, respectively, of the banking sector's outstanding. CUB's advances and deposits grew at a CAGR of about 15% and 11%, respectively, during April 2015-March 2018 compared to the private sector banks' growth of about 19.2% and 17.1%, respectively (5.6% and 7.6%, respectively, for the overall banking sector) during this period. In line with its concentrated branch presence, about 64% of the advances and 79% of the deposits were from TN in June 2018. ICRA expects the bank's operations to remain regionally concentrated, going forward. ICRA also expects CUB's share in the banking sector to remain modest, notwithstanding the envisaged advance growth of about 18-20% over the near to medium term.

Moderate asset quality indicators – CUB's gross NPAs increased to 3.0% in June 2018 (3.0% in March 2018) from 2.4% in March 2016 because of the subdued operating environment. ICRA notes that CUB's overall SMA-2 stood at 4% in March 2018 (3.0% in June 2018). However, the SMA-2 accounts with loans outstanding exceeding Rs. 5.0 crore were lower at ~1.4% of the total advances in March 2018. The granular nature of its advances, the sole banking arrangement for close to 95% (in March 2018) of its exposures and the secured nature of its loans are expected to partially offset the inherent credit risk of the target borrower segments. While close to two-third of the advances comprise working capital finance,

³ PAT less dividend as a proportion of average net worth

CUB's exposures are generally secured by fixed assets (residential/commercial) to the extent of 75-80% of the loan value. This is over and above the movable asset/book debt security of 125% on working capital loans. The bank, therefore, is able to undertake effective recoveries in the overdue or written-off accounts. CUB has negligible restructured standard book and its unprovided security receipts (SRs) stood at about Rs. 200 crore (4.6% of the net worth) as on June 30, 2018.

CUB's fresh slippage rate moderated to 1.8% (annualised) in Q1 FY2019 from 2.4% in FY2016 (2.4% in FY2018). Its ability to keep control over fresh slippages, in view of the prevailing operating environment, would be crucial going forward.

Scope to improve deposit profile – CUB's CASA ratio has improved steadily to 23.9% in June 2018 from 20.4% in March 2016. However, the same was below the private sector average. ICRA notes the granular and retail nature of CUB's deposits, reduction in the share of large deposits (deposits above Rs. 5.0 crore stood at 9% of the total term deposits in March 2018 vis-à-vis 11% in March 2017) and the bank's negligible dependence on certificates of deposit. This provides comfort from a liquidity perspective. However, the bank's ability to improve its deposit profile and growth would be critical for its overall liquidity and earnings, as deposit growth during April 2015 to March 2018 at 11% (CAGR) lagged the advances growth of 15% during this period, resulting in the CD ratio increasing to 85% in March 2018 compared to 75% in March 2015.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[ICRA's Credit Rating Methodology for Banks](#)

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 June 30, 2018, it had a network of 601 branches and 1,634 ATMs with about 89% of the total branches being in South India. With a net worth of Rs. 4,329 crore as on June 30, 2018, the total asset base was Rs. 39,870 crore on that date.

For Q1 FY2019, the bank reported a net profit of Rs. 161.6 crore (Rs. 140.3 crore in Q1 FY2018) on a total asset base of Rs. 39,870 crore (Rs. 35,329 crore as on June 30, 2017).

For FY2018, CUB registered a net profit of Rs. 592.0 crore (Rs. 502.8 crore in FY2017) on a total asset base of Rs. 39,937 crore as on March 31, 2018 (Rs. 35,271 crore as on March 31, 2017).

Key financial indicators

	FY2017	FY2018	Q1FY2018 (unaudited)	Q1FY2019 (unaudited)
Net Interest Income	1,198.8	1,430.3	342.4	374.8
Profit before tax	692.8	790.0	180.3	221.6
Profit after tax	502.8	592.0	140.3	161.6
Gross advances	24,112	28,239	24,058	28,215
Total assets (net of revaluation reserve)	35,271	39,937	35,329	39,870
%CET 1	15.4%	15.8%	15.4%	15.6%
%Tier 1	15.4%	15.8%	15.4%	15.6%
%CRAR	15.8%	16.2%	15.9%	16.1%
%Net Interest Margin	3.6%	3.8%	3.9%	3.8%
%Net Profit / ATA	1.5%	1.6%	1.6%	1.6%
%Return on Average Net Worth	15.2%	15.3%	15.4%	15.2%
% Gross NPAs	2.8%	3.0%	3.0%	3.0%
% Net NPAs	1.7%	1.7%	1.8%	1.7%
% Provision coverage excl. technical write off	40.1%	44.6%	42.0%	44.4%
% Net NPA/ Net worth	11.4%	11.4%	11.5%	10.9%

Source: CUB and ICRA research; Amounts in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

S. No	Instrument	Current Rating				Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	FY2019		FY2018	FY2017	FY2016
					September 2018	August 2018			
1	Issuer rating	Long-term	-	-	[ICRA]AA-(Stable)				
2	Certificates of Deposit Programme	Short-term	25.00	NA	[ICRA]A1+	[ICRA]A1+	-	-	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer rating	-	-	-	-	[ICRA]AA-(Stable)
NA	Certificates of Deposit Programme	-	-	-	25.00	[ICRA]A1+

Source: CUB

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