

November 28, 2024

City Union Bank Limited: Ratings reaffirmed; outlook revised to Positive from Stable

Summary of rating action

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

* Instrument details are provided in Annexure I

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

Rationale

The revision in the outlook to Positive reflects ICRA's expectation that City Union Bank Limited's (CUB) asset quality, solvency¹ and profitability metrics will remain comfortable in the near term. ICRA notes that the bank is taking steps towards improving its geographical diversification, though this will be a gradual process and would be achieved over the medium-to-long term. The ratings reaffirmation continues to factor in CUB's strong capitalisation profile (core equity tier I (CET I) ratio of 21.98% as on September 30, 2024) along with its healthy profitability and return metrics. Further, the bank's established retail franchise comprises a reasonably granular asset and liability base with the same expected to be maintained, thereby supporting the liquidity profile. However, the comparatively lower share of current account and savings account (CASA) deposits in the total deposits keeps the cost of interest-bearing funds relatively above the private sector average. Despite the increase in the overall cost of interest-bearing funds, leading to a relative compression in the net interest margin (NIM), the return metrics remained healthy, supported by benign credit loss provisions.

ICRA also notes the continued improvement in the bank's headline asset quality metrics and the declining share of vulnerable loans (overdue loan accounts, i.e. SMA²-1 and SMA-2 advances, standard restructured advances). However, the overall vulnerable book remained sizeable at 5.9% of the standard advances as on June 30, 2024. The performance of the residual vulnerable book would remain a near-to-medium-term monitorable, especially in the backdrop of the persisting high interest rates, geopolitical issues and concerns around overleveraging among retail borrowers. Nevertheless, CUB is expected to remain well placed to absorb these shocks through its operating profitability. ICRA also expects the bank to remain sufficiently capitalised with no regulatory or growth capital requirements in the near-to-medium term. Additionally, the high regional concentration of CUB's operations and the moderating, yet sizeable, share of the top 20 depositors in the total deposits compared to peer banks remain constraining factors from a credit perspective. The bank also saw a steep decline in its daily average liquidity coverage ratio (LCR) to 116% in Q2 FY2025 from 262% in Q1 FY2025 due to the higher outflow rates for its deposits. These rates were in compliance with the suggestions made by the regulator.

¹ Solvency is defined as $(NNPAs + Net\ security\ receipts + Net\ non-performing\ investments) / Core\ capital$

² A special mention account (SMA) 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

Key rating drivers and their description

Credit strengths

Strong capitalisation profile supported by healthy internal accruals – CUB’s capitalisation profile remains strong with CET I and

Tier I capital ratios of 21.98% each, as on September 30, 2024, which remained comfortably above the regulatory requirement of 8.0% and 9.5%, respectively. The capital ratios continue to be supported by healthy internal accruals and the lower risk-weighted density of assets. Further, internal capital generation has been adequate to meet the credit growth since the last capital raise in FY2015. The strong capital position will act as a good cushion against the expected slippages from the vulnerable book over the near-to-medium term.

Earnings profile remains healthy – CUB’s NIM remained range-bound at 3.17% in H1 FY2025 (3.09% in FY2024), mainly due to the increase in the yield on advances, resulting in a relative uptick in the lending spreads. It remained below the private sector banks’ (PVBs) average (3.9% in FY2024) on account of the comparatively higher funding cost and the sizeable share of the relatively low-yielding gold loans. However, NIMs continue to be supported by the granular nature of the loan book for micro, small and medium enterprises (MSMEs). The share of low-yielding gold loans (including agriculture loans backed by gold) too remained steady, accounting for 25% of gross advances as on September 30, 2024 (25% as on September 30, 2023).

The net profitability remained supported by the benign credit costs of 0.31% (annualised) in H1 FY2025 (0.48% in FY2024). As a result, the return on assets (RoA) stayed healthy at 1.55% in H1 FY2025 (1.48% in FY2024). Lower credit costs are also linked to high recoveries from NPAs, given the granular and secured loan book. With the expected uptick in the slippage rate and the slowdown in the extent of recoveries/upgrades, credit costs are likely to normalise. Despite this, the profitability is expected to remain healthy.

Granular asset and liability base – CUB has an established retail franchise with more than 119 years of operations in South India. The top 20 exposures accounted for ~35% of the Tier I capital as on March 31, 2024 (~35% as on March 31, 2023). Similarly, CUB has a strong retail deposit franchise with limited dependence on bulk deposits. More than 73% of the term deposits, as on June 30, 2024, had a ticket size of less than Rs. 1 crore.

Despite its limited dependence on bulk deposits, the bank’s cost of average interest-bearing funds remained high at 5.64% in H1 FY2025 (5.28% in H1 FY2024; 5.33% in FY2024) compared to the PVBs’ average (5.42% in FY2024). This was on account of the relatively lower share of CASA deposits in the overall deposit base (29.4% as on September 30, 2024; 29.6% as on September 30, 2023).

Credit challenges

Asset quality remains a monitorable – The annualised gross fresh NPA generation rate moderated to 1.59% in H1 FY2025 from 2.41% in FY2024 and 3.39% in FY2023. Moreover, recoveries and upgrades remained strong, resulting in a steady improvement in the headline asset quality metrics with the gross NPA (GNPA) and net NPA (NNPA) at 3.54% and 1.62%, respectively, as on September 30, 2024 (4.66% and 2.34%, respectively, as on September 30, 2023).

Despite the satisfactory asset quality metrics, the overall vulnerable book remained sizeable at 5.9% of standard advances as on June 30, 2024, even though it declined consistently from the higher level of 12.8% as on March 31, 2022. The asset quality will remain a near-to-medium-term monitorable, given the relatively elevated (though moderating) share of the vulnerable book in relation to the total standard assets and the core capital and the concerns around overleveraging in the retail segment amid the persisting elevated interest rate environment and geopolitical issues. ICRA expects that CUB’s healthy operating profitability and robust capital position will help it absorb the asset quality pressure in the coming years while maintaining a strong capitalisation profile.

Geographically concentrated operations – The bank’s operations remain geographically concentrated with ~86% of its total branches (700) located in southern India and 65% in Tamil Nadu as on September 30, 2024. As a result, 86% of the advances

and 92% of the deposits were from southern India (66% and 80%, respectively, from Tamil Nadu) as on September 30, 2024. Moreover, the share of the top 20 deposits in the bank’s total deposits, though moderating, remained comparatively higher than peer banks at 8.67% as on March 31, 2024 (10.94% as on March 31, 2023). This exposes its assets and liabilities to local socio-economic and political risks. ICRA expects CUB’s operations to remain regionally concentrated with the same unlikely to improve in the medium term.

Environmental and social risks

While banks like CUB do not face material physical climate risks, they are exposed to environmental risks indirectly through their asset portfolio. If the entities or businesses, to which banks and financial institutions have exposure, face business disruptions because of physical climate adversities or if they face climate transition risks because of technological, regulatory or customer behaviour changes, the same could translate into credit risks for banks. However, such risks are not material for CUB as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively fewer downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. CUB has not faced such lapses over the years, which highlights its sensitivity to such risks. It is seen to be operating responsibly in terms of its selling practices, with no instances of fines being imposed by the regulatory authorities because of misconduct. Customer preference is increasingly shifting towards digital banking, which provides an opportunity to reduce operating costs. CUB has been at the forefront of making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent, as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

CUB’s liquidity profile remains strong with excess statutory liquidity ratio (SLR) holding of 7.2% of net demand and time liabilities (NDTL) as on August 23, 2024, which partly supports the positive cumulative gaps across all the near-term maturity buckets as per the structural liquidity statement as on June 30, 2024. The bank’s LCR declined to 116% in Q2 FY2025 from 262% in Q1 FY2025, following the recalibration of its outflow rates. The net stable funding ratio (NSFR) stood at 155% in Q2 FY2025, which was well above the regulatory ask of 100%. 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 upgrade the rating if the bank continues to maintain healthy asset quality and profitability while also increasing the geographical diversification of its asset and liability base outside Tamil Nadu.

Negative factors – ICRA could revise the outlook to Stable 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 a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA’s Rating Methodology for Banks and Financial Institutions
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, 2024, it had a network of 812 branches and 1,682 ATMs with about 86% of the total branches in South India. About 54% of its branches were in semi-urban and rural areas as on September 30, 2024. CUB reported a capital adequacy ratio of 22.98% (Tier I: 21.98%) and gross and net NPAs of 3.54% and 1.62%, respectively, as on September 30, 2024. The bank reported a net profit of Rs. 550 crore in H1 FY2025 on an asset base of Rs. 71,366 crore compared to a net profit of Rs. 508 crore on an asset base of Rs. 67,274 crore in H1 FY2024.

Key financial indicators (standalone)

City Union Bank	FY2023	FY2024	H1 FY2025
Total income	2,966	2,832	1,525
Profit after tax	937	1,016	550
Total assets (Rs. lakh crore)	0.67	0.71	0.71
CET I	21.27%	22.69%	21.98%*
CRAR	22.34%	23.73%	22.98%*
PAT / ATA	1.46%	1.48%	1.55%^
Gross NPAs	4.37%	3.99%	3.54%
Net NPAs	2.36%	1.97%	1.62%

Source: City Union Bank, ICRA Research; Amount in Rs. crore unless mentioned otherwise; All ratios as per ICRA's calculations; ^ Annualised
*CET I and CRAR exclude profits for H1; Total income = Net interest income + Non-interest income (excluding trading gains)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current (FY2025)			Chronology of rating history for the past 3 years					
	Type	Amount rated (Rs. crore)	Nov 28, 2024	FY2024		FY2023		FY2022	
				Date	Rating	Date	Rating	Date	Rating
Issuer Rating	Long term	-	[ICRA]AA-(Positive)	09-Nov-23	[ICRA]AA-(Stable)	17-Nov-22	[ICRA]AA-(Stable)	22-Nov-21	[ICRA]AA-(Stable)
Certificates of Deposit	Short term	25.00	[ICRA]A1+	09-Nov-23	[ICRA]A1+	17-Nov-22	[ICRA]A1+	22-Nov-21	[ICRA]A1+

Complexity level of the rated instruments

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: [Click Here](#)

Annexure I: Instrument details

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

Source: City Union Bank; * Certificates of deposit outstanding was NIL as on November 15, 2024

Annexure II: List of entities considered for limited consolidated analysis

Not applicable

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Branches



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