CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – JUNE 2016

Good evening everybody, Dr. Kamakodi here.

Hearty welcome to all of you for this conference call to discuss Q1 FY 2017 financial results of City Union Bank. The Board of Directors adopted the unaudited results today at Chennai.

I will brief the overview and Mr. Ramesh, CFO will run through the numbers and at the end we can have the Q & A.

Hope you all have received the presentation.

On the management side I would like to inform that on 21st July, 2016 Shri. S. Bernard, a practicing Chartered Accountant has been inducted into the Board. One of the existing directors Sri. R G Chandramogan retired on 29th July 2016 after completing his full term of 8 years. Sri. S. Bernard served the Board earlier during 2006 to June 2014.

This year the Annual General Meeting (AGM) of the bank is scheduled to be held on the 22nd August, 2016 at Kumbakonam. We invite all the shareholders to attend the Annual General Meeting.

In that meeting we are seeking the shareholders approval for two enabling resolutions. One is for QIP issue of Rs.500 cr. We have been getting approval for QIP issue every year since FY 2008-09 but used it only once when we went for a QIP in July 2014. We are presently adequately capitalized and there is no immediate need for raising capital and hence the QIP approval is only an enabling resolution The Second enabling resolution is for employee reservation in the rights issue if any based on SEBI guidelines as we did in 2012-13.

Both are enabling resolutions only and we may use them only if needed.

The highlights of the Q1 financial results are as follows:

The Q1 performance has been in line with the expectation which we have shared with you last time. Because of the economic downturn and Reserve Bank's Asset Quality Review hardly a handful of banks are able to show decent growth and asset quality numbers.

Our numbers are stable and satisfactory.

We closed Q1 FY 2017 with Rs.124 cr in PAT, a 11% growth over corresponding quarter last year while showing 20% growth in Operating Profit, 25% increase in Net Interest Income and 19% enlargement in credit growth.

As informed during the last con-call, our expectations for the year are as follows:

- Achieving a net profit growth of 10 – 12%
- Achieving a Credit growth between 15 – 18%
- Keep incremental slippage ratio below 2%

Though the profitability growth in Q1 corresponds with our projections, we expect to incur an incremental expenditure of Rs.40 cr – Rs.50 cr because of wage revision. The incentive received from RBI in Q1 FY 16 last year for installing Bulk Note Acceptor in branches is not available for this year. Despite these limitations, we still believe that we can achieve the desired growth in profits although there could be some quarterly aberrations. The impact of salary will be visible from second quarter onwards.

We had consistently maintained the ROA at 1.50% in the past. For this quarter it is at 1.55%.

Between 30th June 2015 and 30th June 2016, the credit has grown by 19% over and above the expected growth of 15-18%. If you look at closely, it is because of base effect. Last year the credit outstanding got reduced by 188 cr during the first quarter a regular phenomenon that we witness in every first quarter. But this year the reduction is only Rs.38 cr over the March 2016 number.

Slippages for the current quarter is Rs.100.53 cr translating into an annualized slippage ratio is 1.88% which is well within the 2%, the figures we shared with you all. The incremental addition comprises of many small accounts and no single account is more than Rs.12 cr and it is spread across various industries.

Going by the preset trend, we still believe that we could restrict our slippage ratio anywhere between 1.75% and 2.00% for the whole of FY 2017. You need not worry too much about SMAs numbers and all. As you may observe, the incremental slippage ratio is in decreasing trend from FY 13-14, 14-15 and 15-16 when it was 2.81%, 2.35% and 2.02% respectively.

In this financial year we expect that the numbers to settle between 1.75% and 2.00%. Even during the best of years slippage ratio used to be between 1.25 – 1.50% and I think we are probably 1.5 to 2 years away from achieving these numbers.

We were discussing about 2 – 3 stressed accounts under pipe-line which are above Rs.50 cr – Rs.60 cr of exposure. Out of that, one account from Iron & Steel sector has become NPA during Q4 FY 2016. Even though the other two stressed accounts are showing some marginal improvement in account operations, we are still keeping them under watch list.

Still the recovery of NPA account by liquidation of collaterals continues to be an issue. Liquidation is not happening as fast as we want. It will improve only when you see the signs of general economic recovery. We are waiting for the right signals and we hope some positive turn around will emerge by the current year end. The reduction in the NPA ratios will start happening only from that point.

The core profitability and efficiency ratios like ROA, ROE, Cost to Income ratio and the NIM are closer to the best in the banking industry. ROA is 1.55%, ROE is 16.00%, Cost to Income Ratio is at 39.72%, NIM is holding at 4.07% signaling that decreasing interest rate pressure has not still built up in the market. Still the yield reduction is not as much fast as cost reduction. As we used to discuss about the progress in technology adaptation, there is a possibility of improving the alternate channel transactions by 3-5% which is presently hovering around 80%. However, the Cost to Income Ratio will increase by 3-4 % on account of the proposed salary revision coupled with absence of incentives on BNA given by RBI last year.

To sum up,

It is one more usual stable quarter without much surprises. We are keeping the fingers crossed and waiting for the general economic turnaround to accelerate the growth. At the same time we definitely believe incremental pressure on asset quality will ease.

Now Mr. Ramesh will explain numbers. Over to Ramesh.

Thank you MD sir … I am Ramesh, CFO. Good evening everybody and thank you for attending the City Union Bank's earnings call of Q1 FY 17.

Let us get into the details of the first quarter results:

In a nutshell, the Bank has recorded a growth of 20% in Operating profit in Q1 FY 17 over the corresponding period in Q1 FY 16. In absolute terms the Operating profit increased from Rs. 197 cr to Rs. 236 cr. Similarly the Net Profit for Q1 FY 2017 has increased by 11% over Q1 FY 16. In absolute terms the net profit increased to Rs. 124 cr from Rs. 112 cr. The Net NPA sequentially increased by 6 bps in Q1 FY 2017 to 1.59% viz-a-viz 1.53% as on 31.03.2016.

Coming to the Business growth, our Deposits have increased by Rs.2825 cr from Rs.25111 cr to Rs.27936 cr in Q1 FY 16 thereby registering a growth of 11%.

Similarly, for the quarter ended 30th June 16, our Advances increased by Rs.3315 cr from Rs.17901 cr to Rs.21216 cr translating into a 19% growth. Thus the total business grew by 14% from Rs.43012 cr to Rs.49151 cr on y-o-y basis.

CASA has increased by 21% in absolute terms by Rs. 1017 cr from Rs. 4740 cr in Q1 FY 16 to Rs.5757 cr in Q1 FY 17. The current account portion has increased by 14% and the savings account portion higher at 26%. The share of CASA to total deposits was 21%.

The higher liquidity and accommodative stance of RBI resulted in Cost of Deposits for Q1 FY 17 falling by 73 bps to 7.12% from 7.85% compared with Q1 FY 16. Cost of Deposits for the sequential quarter Q4 FY 16 was 7.39%.

The Yield on Advances for Q1 FY 17 stood at 12.36% as compared with 12.95% in Q1 FY 16. For sequential quarter Q4 FY 16 it stood at 12.59%.

The interest yield on Investments has increased by 7 bps to 7.46% for Q1 FY 17 as compared to 7.39% for Q1 FY 16 and in Q4 FY 16 it stood at 7.48%.

The Net Interest Income for Q1 FY 17 stood at Rs.280.02 cr as against Rs.223.63 cr in the corresponding period in FY 16 thereby registering a growth of 25%. The Net Interest Margin for Q1 FY 17 stood higher at 4.07% vis-à-vis 3.59% in Q1 FY 16.

The non interest income of the bank in Q1 FY 17 was Rs.111.11 cr as compared to Rs.104.89 cr in Q1 FY 16 reflecting a marginal increase of 6%. For sequential quarter it was Rs.107.26 crs. The major contribution had been derived from profit on sale of securities which has contributed Rs.24.73 crs. In last year Q1 FY 16, we have received IT refund and incentive for installation of Bulk Note Acceptor (BNAs) amounting to Rs. 16.46 crs (11.58+4.88) which is not available for the current year.

Other operating expenditure has increased by 18% in Q1 FY 17 from Rs.131.36 cr to Rs.155.36 cr. The increase is on account of normal rise in expenses like Salaries, Rent, Electricity, Repairs and maintenance, Depreciation, etc. Out of the above, the establishment expenses (salaries) increased from Rs. 48 cr to Rs. 63 cr in Q1 FY 17. Every year we are in the practice of paying ex-gratia to all employees on two occasions – one during first quarter and another during festival season i.e in the third quarter. The Exgratia for last year Q1 FY 16 was finalized in March 2015 itself and we have provided a sum of Rs.10 cr for the same in Q4 FY 15. So, the provision has been adjusted towards ex-gratia payment in the last year Q1 FY 16 and because of that effect, the growth stands at 31%.

The operating profit for Q1 FY17 has thus increased by 20% from Rs.197.16 cr to Rs.235.77 cr.

For Q1 FY 2017, the total provisions have increased by 31% from Rs.86 cr to Rs.112 cr due to higher provisions for NPA, Tax and standard assets. We made 15% provision as advised by RBI to all consortium banks (7.50% during March16 and 7.50% in this quarter), in connection with the lending to Government of Punjab under food credit which amounts to Rs. 13 cr based on the balance outstanding as at the end of Q1 FY17. During the quarter, an amount of Rs. 30 cr was repaid by Punjab State Government. Earlier, we had made a provision of Rs.9 cr during Q4 FY 16.

We have provided Rs.41.50 cr towards taxation as against Rs.40.50 cr last year, Rs.67.00 cr towards NPA as against Rs.50.00 cr provided last year and Rs.3.42 cr towards Standard Assets.

Thus, total PAT for Q1 FY 17 increased by 11% from Rs.111.56 cr to Rs.123.52 cr.

The Return on Assets for Q1 FY 17 stood at 1.55% Vs 1.57% in Q1 FY 16. The Return on Equity stood at 16.00% for Q1 FY 17 as against 16.43% for Q1 FY 16.

Cost to income ratio decreased to 39.72 % for Q1 FY 17 from 39.99% in Q1 FY 16 and for Q4 FY 16 it was 39.73%.

For Q1 FY 17, the additions to NPA account was Rs.100.53 cr vs Rs.77.62 cr in Q1 FY 16 and lower than Rs.127.42 cr in sequential quarter Q4 FY 16.

During the year we have not Restructured any accounts and nor sold any assets to ARCs. On the accounts we sold to ARCs in earlier years for which we hold SRs there were no provisions required to be made based on NAVs.

The total restructured standard advances currently stood at Rs.188.80 cr which is 0.89% of our Gross advances. In Q1 FY 17, 5 small accounts aggregating to Rs. 9.30 cr slipped to NPA from restructured standard category.

With this I conclude and over to you for questions.

Question & Answers:

Q : What is your core Tier I capital for June 2016?

Ans: The core Tier I capital is 14.76% as per Basel III.

Q : What is the expected growth rate for this year?

A : We are targeting a growth rate of 15 – 18% for advances for the current year. We are not chasing the growth and we want to ensure the quality of assets. Now, things have started to improve and we also waiting for the appropriate time to achieve reasonable growth of advances.

Q : Where the growth comes from and is it by way of acquisitions or new advances?

A : As we have observed 1/3rd of the growth comes from enhancement to the existing borrowers arising out of inflation. Another 1/3rd of the growth comes from branches which are more than 5 years old in the form of new advances as well as acquisitions from other banks mainly from PSBs. The balance 1/3rd comes from branches opened less than 5 years.

Q : Your experience on liquidation of collaterals?

A : Our collaterals are mainly by way of Factory buildings and residential properties of the borrowers. Generally we used to have a recovery of 70 – 75% value of collaterals in the past. Now a days the recovery is slow and buyers are not forth coming to acquire the properties.

Q : Why the credit cost is increasing now?

A : Earlier our credit cost use to be 30 – 40 bps and 50 bps at the most. Presently it is around 80 bps. The credit cost is the net of provisions less recoveries in technically written off accounts. Since the recoveries are slow as I stated earlier the credit cost is higher. We expect it to moderate with the improvement in the overall economy.

Q : Why your fee income is very weak?

A : We have never been strong on fee income and CASA. Our other income consists of core fee income from loan proposals, treasury income and recoveries from written off accounts. Core fee income is slightly less than credit growth. Core fee income is never been our core strength. The operating expense is normally higher than the other income. Accordingly, 70 - 75% of net interest income constitutes operating profit. Within the other income, fall in one segment is compensated by other segments.

Q: What about Margin contraction?

A: The present CD ratio is low. We have surplus funds to meet advances up to ` 1000 – 1500 crs without increasing deposits. We have reduced interest on deposits and cut down bulk deposits. The reduction in interest rate cycle is happening in the last one year. As reduction in yield on advances is lower than the reduction of CoD the margin is quite comfortable. The margin contraction will begin only with higher growth of advances.

Q : Whether slippages are higher in SME segment due to commodity cycle?

A : SME is not bad as it is perceived in the industry. With respect to the commodity cycle, the cotton prices have increased by 15 – 20% in the last 2 - 3 months while the iron and steel prices have come down. And hence, it has not affected the SMEs to a large extent.

Q : How you are seeing liquidation of collaterals?

A : Generally we used to recover 50 – 60% of the slippages in the first year. Presently, the market liquidity in the real estate sector has dried up. Though the borrowers are co-operating for the realization of collaterals there are no buyers to take over.

Q : Your comments on Gold loan portfolio / growth on the same?

A : When compared to last year Q1 FY 16, there is a de-growth of ` 200 cr in that segment. Due to good monsoon, we hope there is scope for growth in agriculture gold loan and the phase of reduction may also come down. Our Gold loan portfolio mainly consists of agriculture gold loans. Since there is an increase in gold prices it may lead to growth in the gold loan segment and also reduction in redemptions.

Q : What is your view on Gold loan Auctions?

A : If we conduct 10 auctions we cannot able to complete more than 2 auctions. It is a function of sentiment and no one is approaching for negotiation.

Q : Reasons for increase in establishment costs in Q1?

A : Every year we are in the practice of paying ex-gratia to all employees on two occasions – one during first quarter and another during festival season i.e in the third quarter. The Exgratia for last year Q1 FY 16 was finalized in March 2015 itself and we have provided a sum of Rs.10 cr for the same in Q4 FY 15. So, the provision has been adjusted towards ex-gratia payment in the last year Q1 FY 16 and because of that effect, the growth stands at 31%.

Q : What is the expected salary increase on account of wage revision?

A : The increase in wage due to salary revision may be ` 10 cr – ` 15 cr per quarter from Q2 onwards.

Q : Why you are not going for wholesale advances?

A : We are not in favour of consortium financing and we would like to be sole bankers for the borrowers. Presently, PSBs are in the process of cleaning their balance sheet. Once they start advancing loans, credit growth will be seen and will be borrowers market. We are not aggressive on the loan growth as the proposals are not conforming to my risk appetite.

Q : Can you throw some light on growth in SME / Traders segment?

A : Going forward loans to SME / Traders will be the main drivers of our credit growth. 2/3rd of our loan books consist of these segments.

Q : What about capital raising plan?

A : At present we have a capital adequacy ratio of 15.25%. Though we are seeking shareholders approval for enabling resolution to raise capital through QIP route we are not desperate in raising capital. Normally we go for capital expansion when the capital adequacy ratio touches around 13%.

Q : What about branch expansion plan?

A : We have been opening 50 branches in the last 3 – 4 years. This year we contemplate opening 50 – 75 branches. Out of this, we plan to open 50% in Tamilnadu, 25% in neighboring states and the remaining 25% in other states. This pattern will continue till we attain 500 – 600 branches network in Tamil Nadu.

Q : What about monitoring of SME accounts?

A : With the help of core banking, we are in a position to monitor the movements in the account for taking timely actions. We are giving reports on adverse operations to the branch managers for immediate and corrective action. Branch managers in turn approaches the customer to take necessary steps to address the problem.

Q : What is o/s in 5 / 25 and SDR?

A : We don't have any such accounts.

Q : What about competition in financing in SMEs from Small Finance Banks?

A : We observe that SFBs are charging higher interest for loans with NIM of 10% as against our margin of 3.50% – 4.00%. The SFBs are not in a position to reduce their lending rates as they have to lend 90% of their loan book for less than 5 lakhs which calls for higher deployment of field staff adding to operating cost. Some large banks are not as empathetic as we are towards SME customers. Hence, we don’t foresee much competition from SMEs.