CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – SEPTEMBER 2018

Good afternoon to all, Dr. Kamakodi here.

Wish you all a happy Diwali and Happy new year.

Hearty welcome to all of you for this conference call to discuss Q2 and H1 FY 2019 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. At the end we can have Q & A.

On 31.10.2018, the bank celebrated its 115th foundation day and the operations of the bank were started at Kumbakonam on 01.11.1904. We thank all stakeholders, customers all of you for the wishes and continuous support.

The major development happened in this quarter is the receipt of long term issuer rating "AA-" from rating agency – ICRA. The timing of this rating is important particularly when the industry is going through turbulent times. We had also been awarded 'CRISIL A1+' rating for issuance of Rs. 250 cr Certificate of Deposits.

Apart from this, it is a normal quarter without much surprises – Positive or negative.

Between 30.09.2017 and 30.09.2018,

- ✓ Advances grew by 17% inline with our shared expectation of 18-20% for whole year FY 18-19.
- ✓ There is a dip in Operating profit as discussed during last concall because of non availability of profit making opportunities on treasury

- ✓ As shared during last concall, still we achieved 16% PAT growth mainly because of better NPA / recovery management.
- ✓ The growth in pre-tax profit for Q2 is 20% and for H1 FY 2019 is 21%.

The slippage ratio as % to closing advances for Q2 FY 19 is 1.83% and for H1 FY 19 is 1.76% against expectation of 1.75% - 2% to closing advances what we shared during the beginning of the year. We had slippage of Rs.136 crs in current quarter against recovery of Rs.66 cr in live accounts and Rs.18 cr in TW accounts i.e Rs. 84 cr in total.

RoA and ROE for Q2 are at 1.62% and 15.20% in tune with our past trend. NIM has increased to 4.32% in Q2 Vs 4.24% in Q1 FY 19 against our expectation of contraction.

Cost to Income ratio is slightly elevated at 41.66% for H1 FY19 due to reduction in other income as opportunities in Treasury did not exist.

All the parameters are in line with what we shared in the earlier quarters.

Going forward, for the whole year we should be in tune with our expectations of 18-20% growth in loan book, maintaining RoA & ROE at current level.

During earlier concall, we spoke about two accounts with an exposure of over Rs.50 cr – one paper mill and another education institution account. Of these, the education institution, the borrower had sold some properties and remitted funds into their account showing a positive trend and it came out of danger. In case of paper mill, with exposure of Rs. 80-85 crs the project is complete and commercial production had started. But a couple of consortium PSUs have not yet released their working capital. If they release, the unit will survive or else the account will become NPA.

If it slips, there will be a spike in the NPA slippage levels for a quarter. But we are hopeful that our annual slippage to closing advances will still be between 1.75% - 2% as discussed.

We don't have any direct exposure to ILFS group or other NBFCs which are in news now for wrong reasons.

No un-provided depreciation in Treasury. We also have made full provision to cyber issue happened last year, pending claim settlement from insurance. We have made Rs. 8 cr provision for SR this quarter in line with our plan for increasing the coverage.

Over to CFO Shri. Ramesh.

I am Ramesh, CFO.

Good evening everybody and thank you for attending the City Union Bank's earnings call of Q2 FY19 / H1 FY19.

Let us get into the details of the second quarter & first half results:

The Operating profit during the period decreased as per our expectations and at the same time Net Profit has increased by 16% in both Q2 & H1 FY 19. Also, pre-tax profit improved by 20% for Q2 FY19 and by 21% for H1 FY 19.

The Net NPA has marginally decreased by a basis point sequentially to 1.69% in Q2 FY2019 as against 1.76% in corresponding period last year.

During the period, our Deposits has increased by Rs.3652 cr from Rs.30882 cr to Rs.34534 cr, registering a growth of 12% on y-o-y basis. Similarly, Advances enlarged by Rs.4396 cr from Rs.25389 cr to Rs.29785 cr translating into a 17% growth. Thus, the total business grew by 14% on y-o-y basis.

CASA has recorded a growth of 15%, in absolute terms by Rs.1070 cr from Rs.7094 cr to Rs.8164 cr. The share of CASA to total deposits which was 24% for Q2 FY19. CA portion increased by 9% and SA portion by 19% on y-o-y basis.

The Cost of Deposits for Q2 FY19 decreased by 19 bps to 6.07% from 6.26% compared with Q2 FY18. Cost of Deposits for H1 FY19 was lower at 6.11% vs 6.35% in H1 FY18. We have been operating at a CD ratio of around 85-86% without increasing much deposits. As and when there will be credit growth we may go for more on deposits.

The yield on advances for Q2 FY19 stands reduced to 10.86% as compared to 11.53% for Q2 FY18. The yield on advances was at 10.86% for H1 FY19 vs 11.65% in the last year. The decline in yield is on account of competition in the market. However, yield on advances for Q1 & Q2 FY 19 remains at same level.

The Net Interest Income for Q2 FY19 has improved by Rs.43 cr from Rs. 355 cr in Q2 FY18 to Rs. 398 cr in Q2 FY19 registering a growth of 12%. NII for H1 FY 2019 improved by Rs. 76 cr from Rs. 697 cr in H1 FY18 to Rs. 773 cr in H1 FY19.

The Net Interest Margin for Q2 FY19 has increased to 4.32% from 4.24% in Q1 FY19 (sequential quarter) which is against our expectation of contraction. NIM for H1 FY19 was at 4.28% vs 4.47% in the corresponding period last year.

The non interest income of the bank in Q2 FY19 has decreased to Rs.119 cr as compared to Rs.155 cr in the corresponding quarter on account of decline in profit on trading of securities, IT refund and trading income through PSLC. The treasury profits comprising both domestic and forex segments decreased by 67% from Rs. 65 cr in Q2 FY18 to Rs.21 cr during Q2 FY19. Suit recoveries remained same at ` 18 crs during Q2 FY 19 as compared to corresponding period last year. As against a profit of Rs.11.76 cr by way of sale of excess lending of priority sector advances under PSLC in Q2 FY 18 we were able to make only ` 7.82 crs during Q2 FY19.

The non interest income for the half year has declined by 15% from Rs.291 cr in H1 FY 18 to Rs.248 cr in H1 FY 19. Income from domestic and forex treasury decreased from Rs.104 crs in H1 FY 18 to Rs.41 in H1 FY 19. This also is as per our expectation we shared during our earlier concalls.

Operating expenditure has increased by 16% in Q2 FY19 to Rs. 221 cr from Rs. 190 cr incurred in the corresponding quarter last year. For H1 FY19 Operating Expenses increased to Rs.425 cr from Rs.371 cr in H1 FY18. The employee cost increased from Rs. 83 cr to Rs. 93 cr on Q2 to Q2 basis and it increased from Rs. 159 cr in H1 FY18 to Rs. 180 cr in H1 FY19. The other operating expenses increased from Rs.107 cr in Q2 FY18 to Rs.128 cr in Q2 FY19. For H1 FY 18 it was Rs. 212 cr vs Rs. 245 cr in H1 FY 19. The increase is on account of general increase in rent, taxes (GST), lighting, repairs etc.

Thus, Cost to income ratio increased to 42.71% for Q2 FY19 from 37.26% in Q2 FY18. For the half year ended H1 FY19 the ratio is 41.66% as against 37.54% for H1 FY18. This was mainly on account of non availability of treasury income and reduction in other one time incomes like IT refund, PSLC income.

The operating profit for Q2 FY 19 down by 8% to Rs.296 cr from Rs.320 cr in Q2 FY 18. For H1 FY19 the same has declined by 4% from Rs. 617 cr to Rs. 595 cr in the corresponding period last year.

For Q2 FY19, the total provisions made was Rs.128 cr a decrease of 27% compared to Rs.175 cr in Q2 FY18. Provision for Bad and Doubtful debts decreased from Rs.87 cr to Rs.47 cr for Q2 FY19 on account of reduction in slippages.

For the half year ended 2019, the total provisions decreased by 20% to Rs.266 cr from Rs.332 cr in H1 FY18. The details of provision made during the quarter Q2 FY 19 is as follows;

Rs. in Cr

Provision for NPA	47.00

Provision for Income Tax	60.00
Provision for Std Assets	2.70
Provision towards depreciation in Investments (SRs)	8.00
Provision towards Others	10.26
Total	**127.96**

The details of provision made for the half year is as follows;

Rs. in Cr

Provision for NPA	112.00
Provision for Income Tax	120.00
Provision towards depreciation in Investments (SRs)	16.00
Provision for std assets	3.20
Provision for inv shifting	6.51
Provision – Others	8.01
Total	**265.72**

Thus, PAT for the second quarter thus increased by 16% from Rs. 145 cr in Q2 FY18 to Rs. 168 cr in Q2 FY19. For H1 FY19, PAT registered a growth of 16% from Rs. 285 cr last half year to Rs. 330 cr.

Return on Assets stands at 1.62% for Q2 FY19 as against 1.58% for the corresponding quarter last year while the ROA for H1 FY19 stood at 1.63% vs 1.59% for the corresponding period last year. The Return on Equity stood at 15.20% for Q2 FY19 against 15.24% for Q2 FY 18. Similarly for H1 FY19, ROE stands at 15.29% Vs 15.39% in last year corresponding period.

The Capital Adequacy Ratio (as per Basel III) stands at 15.11% of which core CRAR at 14.71% for H1 FY19.

For Q2 FY19, the gross additions to NPA is Rs. 136 cr compared to Rs. 147 cr in Q2 FY 18 and Rs. 125 cr in Q1 FY19. We have recovered a sum of Rs. 66 cr in NPA accounts during the second quarter. For H1 FY19, the total slippages stands at Rs. 262 cr as against Rs. 294 cr in corresponding period H1 FY18.

Accordingly, the Gross NPA for Q2 FY19 stood at Rs.848 cr Vs Rs.851 cr Q1 FY19 and G NPA ratio decreased to 2.85% from 3.02% sequentially. The Net NPA stood at Rs. 498 cr which is 1.69% of Net Advances Vs 1.76% in the corresponding quarter last year Q2 FY18. We have not sold any assets to ARCs during this quarter.

No account has been restructured during H1 FY 19. The total outstanding restructured accounts stood at Rs.5.67 crs as on 30th September 2018 as against the outstanding of Rs.15.20 cr in Q2 FY 2018. The outstanding restructured accounts to Gross Advances stood at 0.02%.

With this I conclude and over to you all for questions.

Thank you all!

Over to questions:

Q & A:

Jay Mundhra, Batliva & Karani
Q: Any exposure to IL&FS or any other entity? Has the borrower started paying in education institution problematic loan? What is the outstanding amount?

No direct or indirect exposure to IL&FS in any form. Not even in liquid fund. Wrt the problematic account in education institution, the borrower has repaid their dues to some extent and reduced the outstanding balance to Rs.60-65 crs.

Q: Also, cost of deposits have declined QoQ?

We are in increasing interest rate scenario. The hunch says that there should be increase in cost of deposits. We do not expect the cost of deposits to come down.

Q: Now that SR redemption started, where are PCR stabilizing.

We have SR coverage ratio of 45%, slowly we will increase it to 60-65%, not only by provisions, but also recoveries from outstanding of SR as well.

II Gaurav Jani, Centrum Broking

Q: Any colour on slippages? Will these be chunky? On SMA 2 book, can you quantify this? How do you see credit growth, currently 17.5%,

Above Rs 10 Cr, we have only 2 accounts (one is in steel trading – Rs.13 cr & second is in oil trading – Rs.10 cr). Remaining is granular. Overall, we are seeing moderation in incremental slippages. We will hold 1.5%-2% slippages target for the whole year. Except for one large account of Rs 85 Cr which may slip in Q3, 2019, we don't see any major stress.

III Ankit Agarwal – Centrum Broking

Q: Any spends on technology? Any steps taken in light of fraud? What sort of productivity gains we could see in the next couple of years? Any possibility of automated credit? Expectation on Cost to income ratio.

We have been consistently making investments in technology. From FY04, we focused in migrating to non-branch channels. Almost 90% is non-branch driven. We have been taking other initiatives as well. The cyber-attack was unfortunate and fraud in SWIFT happened immediately after migration. Have added multiple security upgrades after this. Our focus and niche area is data collection and analysis will be automated. Anyhow final decision will be manual. The productivity will however be ensured. We do improvements which are core focus and something that adds value to the business. Majority of the time is taken to collate the data, which can be productively done in much less time. Regarding Cost to Income ratio, our last 40 quarters average was around 40-42% except 1 or 2 quarters. It will be in that range. It is not wise to expect that it will come down below 40% due to increase in productivity because of technology initiatives.

Rakesh Kumar, Elara Capital

Q: How is cost of deposits down? How is the scenario in the state in MSME segment?

Earlier we are getting enough deposits for growth. Currently the rate is going up, which is the general expectation. Regarding MSME, we are getting our share of business as usual. Things are improving.

V MB Mahesh, Kotak Securities

Q: Exposure to paper sector. How much is the working capital shortfall? Has GST improved the revenue and profitability of borrowers, Are SME clients asking for higher credits? Do Demand environment continue to be good and Deposit mobilization has lagged loan growth, any reasons?

The gap in working capital shortfall is Rs 40-45 Cr. We have taken a call that even if it becomes bad, we will not fund further and we will come out. This is the state as on date and if things improve, we may go for it, else we will wait. Wrt situation after implementation of GST, based on my understanding, anyone who has taken loan of Rs.70 to 75 Lakhs, they were all fairly organized. Anyone who had taken loan of less than Rs.20-25 lakhs, they were mainly unorganized. We never had to use the dispensation given by RBI for SMEs. SMA 2 number is showing a stable and in fact declining trend as of now. We are getting fresh clients migrating from other banks where their criteria were not fulfilled. We are fine with the branch operating and getting credit.

VI Roshan Chutkey, ICICI Pru AMC
Q: Our 52% of the book is SME with an average ticket size around 45 lakhs and large part of is unorganized, is it safe to say that?

This is not a fair assumption by just dividing the outstanding by total number of accounts and as the number may be misleading.

VII Gaurav Kochar, Ambit Capital
Q: Any colour on capital consumption? Tier 1 was consumed by ~90bps in this quarter. Also, any one-off in the other Operating Expenses, it grew by 19% YoY.

Capital consumption is high as we have not added the unaudited profit for Q1 and Q2 of FY19 to the capital. The advances (RWA) are as at Q2, 2019 but the capital is as at FY18 (without considering profits of 1HFY19). In operating expenses, there is no one-off expenses and everything is regular.

VII Sreenish – Geojit
Q: Some colour on the CASA mix? Why is it low?

It has traditionally been low and will continue to be low.