CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – DECEMBER 2016

Dear Investors/Analysts,

Hearty welcome to all of you for the earnings call for Q3 FY2017 of City Union Bank. Our Board adopted the results this morning. You may have the presentation with you and details are posted in our website.

I will give a brief overview and our CFO Shri. Ramesh will take you through numbers.

Overall we have closed the third quarter with 13% growth in Advances and 32% growth in operating profit and 12% growth in PAT.

On nine months basis, the Bank has recorded 22% growth in Operating Profit and 12% growth in PAT.

Gross NPA for 31.12.2016 stands at 2.98% and Net NPA increased by 9 bps in Q3 and stands at 1.72%.

During the last quarter call, which was immediately after withdrawal of legal tender of Rs.1000/- and Rs.500/- notes, we discussed uncertainty on

- Credit Growth
- NPA Recovery and
- Asset Quality on SMAs / Slippages ratio

We lost whole Q3 as the entire machinery was busy in counting cash and virtually no development happened. CASA grew by Rs.1295 cr in Q3 and we are not sure how much will stay.

Credit recorded a growth of 13% during calendar year 2016. The credit growth during the first half H1 FY 17 was 17%. We have expected 15-18% growth in normal course for FY 16-17. But turn of events now suggests that we will be closing FY 17 with only around 12% credit growth.

As we discussed during last quarter earnings call, the month of September and October 2016 suggested some improvement in the NPA collections but collection came to complete halt in Q3. On the other hand domestic treasury helped us where we booked Rs.46 cr profit in Q3 FY 17. We have booked profits in domestic Treasury taking advantage of softening of yields on Government securities across all the maturities. The yield on 10 year Government security has fallen by 120 basis points from 7.73% (March 15) to 6.96% in Sep-16 and touched 6.18% during November 2016 then further increased to 6.52% in Dec 16. We have booked some profit from HTM portfolio also taking advantage of softening of yield.

You could see Rs. 414 cr de-growth in advances portfolio in Q3 and much collections came in good accounts contrary to expectations.

We reported SMA position improving in Q2. The happening in Q3 resulted in SMA position going back to March position. There is nothing much to worry about.

We shared our slippage ratio will be just under 2% for FY 2016-17 during year beginning, but it is 2.17% for the reasons best known. RBI dispensation made us to classify smaller accounts totaling Rs.18.19 cr as standard assets.

The slippage for the current quarter is Rs.118 cr as against Rs.122 cr during the previous quarter. The incremental slippage is on account of a Steel manufacturing account of Rs.44 crore, Textile account Rs.7.85 cr, Educational Institution of Rs.6.00 cr and remaining being small accounts spread across various industries. 2 - 3 stressed accounts over Rs. 50 Cr, which we have been sharing with you in the last 4 to 6 quarters are still holding and making payments till now. We have to wait and watch whether they will survive or not.

There were no restructuring and any sale to ARC during the quarter. The Provision Coverage Ratio stands at 62%.

As you all know we had Rs.373 Cr worth of securitized receipts in our book as on 31st March 2016. Out of this, three big accounts contribute Rs.192 Cr and 51% of outstanding SRs. Though, we witnessed some movement in Q2 FY 17, recovery has slow down on account of demonitisation during the quarter. We have received a repayment of Rs.5.50 cr during January 2017. The repayment schedule will be over 3 to 5 year period. We have started building cushion and currently provided Rs.10 cr during Q3 FY 17 apart from Rs.15 Cr provided during Q2 FY 17 in connection with probable shortfall in the future realisation of Security Receipts.

All other ratios like ROA, ROE and cost to income ratio and all are in the expected range. NIM still holding above 4 % margin contraction should have started already.

During this year we have opened 12 branches as on date and we may close the year with 550 branches. Against the target of 50 branches, we may open only 25 this year and rest may be opened in Q1 or Q2 FY 18.

To sum up,

It is one more stable quarter with satisfactory performance. Recovery of NPA account by liquidation of collaterals continues to be an issue due to demonitisation effect and waiting for turnaround. We are hopeful of maintaining the profitability and efficiency ratios.

In the environment, where systemic average credit growth is around 5% and average Gross & Net NPA approximately at 9% and 5%, our performance is satisfactory.

Now, Mr Ramesh will explain the numbers. Over to CFO Shri. Ramesh.

Good evening everybody and thank you for attending the City Union Bank's earnings call of Q3 FY17 / 9M FY17.

Let us get into the details of the third quarter & 9 months results:

The Bank has shown a growth of 32% in Operating profit in Q3 FY 2017 over the corresponding period and for 9M FY 2017 the growth was 22%.

The Net Profit for Q3 FY 17 & 9M FY 17 has enhanced by 12% when compared to corresponding period.

The Net NPA has marginally increased by 9 bps sequentially to 1.72% in Q3 FY2017 from 1.63% in Q2 FY2017 (sequential quarter).

Our Deposits has increased by Rs.4027 cr from Rs.25959 cr to Rs.29986 cr, registering a growth of 16% on y-o-y basis.

Similarly, Advances improved by Rs.2427 cr from Rs.19374 cr to Rs.21801 cr translating into a 13% growth. Thus, the total business grew by 14% on y-o-y basis.

CASA has recorded a growth of 47%, in absolute terms by Rs. 2303 cr from Rs. 4872 cr to Rs. 7174 cr. The share of CASA to total deposits which was 18.77% for Q3FY16 has increased to 23.93% in Q3 FY17. CA portion increased by 46% and SA portion by 48% on y-o-y basis.

The Cost of Deposits for Q3 FY17 decreased by 81 bps to 6.67% from 7.48% compared with Q3 FY16 due to reduction in the interest rates offered on deposits. Cost of Deposits for 9M FY17 was lower at 6.89% vs 7.67% in 9M FY16.

The yield on advances for Q3 FY17 stands reduced to 12.05% as compared to 12.67% for Q3FY16. The yield on advances was at 12.25% for 9M FY17 vs 12.86% last year. The decline in yield is on account of decreasing interest rate cycle, competition in the market and to retain the existing clients.

The Net Interest Income for Q3 FY17 has improved by 54 cr from Rs. 253 cr in Q3 FY16 to Rs. 307 cr in Q3 FY17 registering a growth of 21%. NII for 9M 2017 improved by 171 cr from 717 cr in 9M FY 16 to 888 cr in 9M FY17.

The Net Interest Margin for Q3 FY17 has improved by 36 bps to 4.18% compared to 3.82% in Q3 FY16. NIM for 9M FY17 was at 4.16% vs 3.74% in the corresponding period last year. We have consistently maintained the 8 quarter average NIM of above 3.50%.

The non interest income of the bank in Q3 FY17 has improved to Rs. 143 cr as compared to Rs.103 cr in the corresponding quarter mainly on account of securities and improvement in collection in written off accounts and insurance commission. The non-interest income for the 9M FY17 increased by 18% to Rs. 358 cr from Rs. 303 cr in 9M FY16.

Further, the treasury profits comprising both domestic and forex segments increased by 151% from Rs.31 crs (HTM – Rs.4 Crs; Fx – Rs.18 Crs) during Q3 FY16 to Rs.78 crs (HTM – Rs.31 Crs; Fx – Rs.33 Crs) during Q3 FY17. For 9M period, profit has increased from Rs.91 crs (HTM – Rs.7 Crs; Fx – Rs.61 Crs) during FY 2016 to Rs.170 crs (HTM – Rs.42 Crs; Fx – Rs.81 Crs) during FY 2017. Profits for the upcoming periods are contingent on the future trajectory of interest rates in the government securities market in India. If the similar trend continues, we might book profit by selling securities from our HTM portfolio.

Operating expenditure has increased by 18% in Q3 FY17 to Rs.176 cr from Rs.149 cr incurred in the corresponding quarter last year. For 9 M FY17 Operating Expenses increased to 500 cr from 410 cr in 9M FY 16. The increase is mainly on account of salary revision.

The employee cost increased from Rs. 63 cr to Rs. 80 cr on Q3 to Q3 basis and it increased from 160 cr in 9M FY 16 to 220 cr in 9M FY17. The increase is on account of the wage revision consequent upon the agreement we entered with Staff Union / Officer Association and Executives of the Bank effective from 01st July, 2016 onwards.

Cost to income ratio decreased to 39.18% for Q3 FY17 from 41.91% in Q3 FY16 on account of higher treasury income & reduction in cost of deposits. For 9M FY17 the ratio was 40.14% as against 40.23% for 9M FY16.

The other operating expenses increased from Rs. 86 cr in Q3 FY16 to Rs. 96 cr in Q3 FY17. For 9M FY 16 it was 250 cr vs 280 cr in 9M FY 17. The increase is on account of general increase in rent, Printing, telephone, lighting, repairs etc.

The operating profit for Q3 FY17 has increased by 32% from Rs. 207 cr to Rs. 274 cr in the corresponding quarter. Similarly operating profit for the 9M FY17 increased by 22% to Rs. 746 cr from Rs. 609 cr for the corresponding period last year.

For Q3 FY17, the total provisions made was Rs. 147 cr, an increase of 57% compared to Rs. 94 cr in Q3 FY16. Provision for Bad and Doubtful debts increased from Rs. 52 cr to Rs. 87 cr for Q3 FY17. Provision for tax increased to Rs. 55 cr in Q3 FY17 from Rs. 29 cr in Q3 FY16.

For the 9M FY 2017, the total provisions increased by 34% to Rs. 372 cr from Rs. 277 cr in 9M FY16.

The details of provision made during the quarter Q3 FY 17 is as follows;

Provision for NPA	87.00 cr
Provision for Income Tax	55.00 cr
Provision towards depreciation in Inv incl SRs	10.50 cr
Standard Assets provision – written back	-2.40 cr
Write back provision on Other losses	-3.00 cr
All other provisions – written back	-0.14 cr
Total	**146.96 cr**

The details of provision made for the 9M FY 17 is as follows;

Provision for NPA	206.50 cr
Provision for Income Tax	142.50 cr
Provision towards depreciation in Inv incl SRs	25.50 cr
For investment shifting	0.33 cr
Standard Assets provision	2.77 cr
All other provisions – written back	-5.39 cr
Total	**372.21 cr**

PAT for Q3 FY 17 and 9M FY 17 thus increased by 12% from Rs. 113 cr in Q3 FY16 to Rs. 127 cr in Q3 FY17 and for 9M period, PAT increased from Rs. 332 cr last half year to Rs. 374 cr.

ROA for 9M FY 17 remains unchanged at 1.50% as that of last period. The Return on equity stood at 15.01% for Q3 FY17 against 15.19% for Q3 FY 16. Similarly for 9M FY17, ROE stands at 15.36% Vs 15.55% in last year corresponding period.

The Capital Adequacy Ratio (as per Basel III) stands at 14.88% of which core CRAR at 14.39% as at 31.12.2016.

For Q3 FY 17, the gross additions to NPA is Rs. 118 cr compared to Rs. 126 cr in Q3 FY 16 and Rs. 122 cr in Q2 FY17. Recovery/upgradation in NPA accounts during the quarter at Rs. 20 cr. For 9M FY17, the total slippages stood at Rs. 341 cr as against Rs. 302 cr in corresponding period 9M FY 16.

Accordingly, the Gross NPA for Q3 FY17 stood at Rs. 650 cr equivalent to 2.98% of Gross Advances Vs 2.37% at the close of corresponding quarter last year. The Net NPA stood at Rs. 371 cr which is 1.72% of Net Advances Vs 1.49% in the corresponding quarter last year. The net NPA during sequential quarter was 1.63%.

We have not sold any assets to ARCs during this quarter. We have not restructured any accounts in the quarter and the outstanding restructured assets to Gross advances stood at 0.87% Vs 1.63% in the corresponding period last year. We have collected a sum of Rs. 1.90 cr towards repayments in the restructured standard accounts during the quarter. During this quarter 4 borrowal accounts slipped into NPA from restructured standard assets amounting to 0.59 cr and one account was closed.

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

Thank you all!

QUESTION & ANSWERS:

Question - On the sustainability in the level of NIM around 4% in light of effect of demonetization and lower credit growth, RBI's policy of holding rates, etc.

Reply – As you rightly said during the period of demonetization, there was heavy inflow of Deposits, CASA and at the same time there was de-growth in advances to the tune of Rs.414 crs. We have already started shedding the high cost deposits 3 – 4 quarters back. Now, the entire banking system is sitting on the surplus liquidity. We expect some more shrinkage in NIM and the banks have started cutting deposit rates. Now both deposit cost & advances yield are coming down, there will not be any drastic reduction in NIM. I don't think any structural change due to demonetization and so far things are stable. We are keeping close eye on what is happening in the market and will take a decision accordingly.

Question – On the behaviour of working capital cycle on counterparties in the light of demonetization and also on recovery front.

Reply – There was a short term impact for in the first 4-6 weeks on the working capital cycle for the customers who dealt mostly in cash. Subsequently, flow has improved and the situations were under control. Even earlier, the customers with borrowal limit of more than 75 lakhs were not affected. Though we are expecting some increase in the slippages in Q4, we could see the overall slippage for the whole year could slightly be higher than 2%. Due to demonetization, the property market was expected to come down by 25% and also there is a news that the correction in the real estate market has already taken place. We have already started initiating the process of liquidating the assets through auction process.

Question - Guidance on slippages and PCR:

Reply - During the year beginning we said that the slippage would be around 2%. By and large the number was the same in Q1 & Q2. In the 3 quarter it was slightly on the higher side due to the reason well known. Overall, we are expecting slippage for the whole year could slightly be higher than 2%. With respect to PCR, as of now it is around 62% and we hope that it will be hovering around the same level.

Question – Reasons for increase in employee expenses, behavioural pattern of Bulk deposits and NIM.

Reply – The employee cost increased from Rs. 63 cr to Rs. 80 cr on Q3 to Q3 basis and it increased from 160 cr in 9M FY 16 to 220 cr in 9M FY17. The increase is on account of the wage revision consequent upon the 5 year agreement that we entered with Staff Union / Officer Association and Executives of the effective from 01st July, 2016 onwards. Due to this, there will be a growth of 25% – 30% in wage expenses for the whole year. Now, our wages is almost similar to PSU banks. On Bulk deposits, traditionally we are not active in the corporate deposit market except from few of our long standing corporate customers. We take care of our liability side most by way of retail deposits and our renewal rate on the same is almost 90%.

Question – On the effect of movement from Base rate to MCLR:

Reply – Majority of our loan book is on floating rate and the migration from base rate to MCLR is almost complete. The final rate at the time of transition does not undergo any major change due to migration process.

Question – Does the employee cost include Bonus and considering the increase in employee cost, what will be the guidance for FY 17-18? Also, explain the effect of pension liability.

Reply – Yes, the Q3 FY 2017 employee cost includes bonus element of Rs.8 crs. Generally we are paying bonus/exgratia to our employees every year 2 times. We want to spread the 2 bonus element to 4 quarters. For Q3 FY 2017, the employee cost stood at Rs.80 crs and this can be taken as the quarterly wage bill for FY 17-18. With regards to Pension Liability, we follow defined contribution towards pension fund rather than defined pension as practiced by IBA. So, we don't have any hidden liability on account of pension payment. There will be some impact due to actuarial valuation on leave encashment but not on pension.

Question – Comments on De-growth in advances in Q3 and guidance for FY 17. Also, bank's comment on tax rate?

Reply – Our advances grew by 13% on Y-o-Y basis for December 2016. We are expecting the whole year growth to be around the same level though we expected 18% growth earlier. Based on the Q4 actuals, we shall discuss the growth pattern for FY 17-18. The tax rate for Q3 is 30% and for 9M is 28%. Normally our tax rate is in the band of 25% to 30%.

Question – Effect of demonetization on small borrowers as most of them are dealing in cash.

Reply – Though some of the SME clients were affected initially their cash flow has improved towards the end of December. Borrowers having more than Rs.75 L exposure are not by and large affected. They already started workings on the transition to GST.

Question – On De-growth in advances as many of the small borrowers are in the un-organised sector.

Reply - There is about 414 cr of de-growth in advances during Q3 FY 2017 by way of deposit of SBNs (500 & 1000 notes). Towards the end of December their cash flow has improved considerably.

Question – On Non Interest Income growth.

Reply – Our Other income is broadly divided into 3 - 4 major heads ie Core Fee Income, Treasury profit, Suit recoveries and all other miscellaneous income. Our Core fee income in the last 4 quarters ranged between Rs.50 cr – Rs.55 cr. Treasury profit is higher due to softening of Gsec yields. Suit recoveries depends on collection of amounts from technical write off accounts by way of liquidation of collateral. The miscellaneous income comprises of small other income and one time income like IT refund & incentives given by RBI on installation of BNA machines. All the above 3 – 4 elements they work in the different pattern and it is difficult to predict them exactly.

Question – Considering the effect of de-monitization & GST, etc on small borrowers, the strategy of the Bank going forward.

Reply – SME borrowers are perceived to be risky. But we are mitigating the loss given default by securing high collaterals. We are also in the process of increasing ticket size slowly and steadily. It is a continuous process depending upon inflation and our comfort stage. We don't want to say that we are drifting away from SME and we don't feel happy in changing anything drastically in shorter time. We are convinced that we are in sweet spot and we don't want to change it.

Question – On De-growth of CASA in the recent times?

Reply – There was a de-growth in CASA of around 400 crs.