CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – SEPTEMBER 2016

Dear Investors/Analysts,

Hearty welcome to all of you for this analyst conference call after second quarter results of FY 2016-2017. Our Board approved the results this morning. I will give a broad overview and our CFO Shri. Ramesh will take you through numbers

The summary highlights are:

1) Growth, Profitability ratios, Asset quality ratios are in line with the expectations we shared at the beginning of the year.

2) After many quarters some green sprouts are visible on recovery front. It may take a couple of quarters to find out whether the trend is sustainable or one off. We should also see how this demonetization of ₹ 1000 / ₹ 500 is going to affect property prices.

3) We are hearing from various quarters that the Indian banking sector is entering into an era of single digit credit growth for various reasons.

Let us discuss about each point:

As you have seen, bank has recorded 15% growth in both operating profit level and net profit between Q2 ending 30th Sep 16 vis-à-vis 30th Sep 15.

Advances have shown a growth of 17% during the same period against expected growth rate of 15% - 18%, we shared during year beginning.

Net interest income has shown a healthier growth of 25% both for Q2 FY17 and H1 FY 17 over the corresponding period last year.

Contrary to the usual pattern of reducing net interest margin (NIM) during reducing interest rate scenario, NIM stays above 4% expanding to 4.23%. Conventional wisdom says margin has to contract. But from when? We are keeping our fingers crossed.

Other ratios like ROA, ROE and all are in tune with our track record of 1.5% + and 15%+ respectively.

Cost to income ratio is 40.68 % even after taking into account salary hike as discussed earlier.

As we have been repeating, between FY 08 and FY 13, we registered a track record of 1.3% to 1.5% annual slippage to NPA which doubled to 2.8% for FY 14. It declined to 2.30% & 2.02% for FY 15 & FY 16 respectively and we shared our expectation that annual slippage ratio should be getting under 2% for FY 17. For the H1 the annualized slippage ratio is 2%. For the whole year FY 16-17, we are working very hard to keep slippage ratio below 2% as shared with you all. Slippage ratio is trending down for the past three years FY 14, FY 15 & FY 16 and we are working our best to keep that trend continuing for the current year also.

Most of the problematic large accounts over ₹50 Cr we shared 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. The fact that borrowers of these accounts are not giving up itself is a good news. One more account of steel trading from Telengana with exposure range of ₹90 Cr or so is getting added with list of causing concern accounts. Normally steel trading accounts don't get in to NPA. It is only steel manufacturing which gets in to NPA. The borrower visited Central Office and assured that he will not let it go, let us hope for the best.

With all these changes in causing concern accounts and SMA level, we are taking our best efforts to keep our slippage ratio under 2% and hope, by God's grace we should be able to achieve this target.

Another positive signal we are feeling is after many quarters, we are seeing something positive on recovery trend. We are seeing some positive things happening in terms of NPA recovery through auction process. From "Zero" level, for the past couple of months 20-25% of auctions are positive and money is received. Once again, whether it is an one-off phenomenon or beginning of a trend, we have to wait and watch. The recent development of demonetization of ₹1000 & ₹500, how it is going to affect real estate market, we have to see.

As you all know we have ₹ 373 Cr worth of securitized receipts in our book as on 30th June 2016. Out of this, three big accounts contribute ₹ 192 Cr and 51% of outstanding SRs. Some movement has already started in these accounts and we are close to resolution on the same. ₹ 7 cr of recoveries has happened in these accounts during Q2 FY 2017. The repayment schedule will be over 3 to 5 year period. We have started building cushion and currently provided ₹ 15 Cr for towards probable shortfall in the future realisation of Security Receipts.

To sum up, some green sprouts are visible. At last some auctions are happening and showing some recovery. SMA – 2 numbers are also showing some reduction. Some resolutions are visible on SR front also.

We have to wait and watch if it is going to be a sustained trend or one off behavior.

Still we have not started pushing for growth. We are continuing with our cautious approach on growth.

I have started hearing from multiple quarters that Indian Banking System's credit growth rate is going to be at higher single digits for medium to long term for various reasons.

(1) 70% of banking system is already over stretched and don't have enough capital to grow.

(2) The proposal to cap total banking sector exposure to a company and push them to tap bond market will reduce the growth rate of credit of the banking system.

(3) Investment cycle is atleast 3 years away. Now only with great difficulty break even level capacity utilization is achieved by and large. Now capacity utilization has to further increase making it necessary for capacity expansion.

(4) When banking sector growth crossed 15% or so five or six years back, inflation was double digits. If you adjust for inflation, credit growth has to be closer to 10%. These reasons make sense and perhaps we are entering a time period when the banking sector can grow only by 10% or so, but within the sector. Some may de grow, some may grow at 5%-10% and some others may grow by 15% - 25%. We are adequately capitalized and don't need any capital infusion in immediate future. Technology upgradations & branch expansion etc., give us enough strength to accelerate the growth further, which we will do once we get comfort on performance of general economy and NPA recovery trend firms up. We are on track on all the efficiency profitability and growth parameters. We are on track for 15%-18% credit growth and working for less than 2% slippage ratio for FY 2016-17.

Over to CFO Shri. 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 Q2 FY17 / H1 FY17.

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

The Bank has shown a growth of 15% in Operating profit in Q2 FY 2017 over the corresponding period and for the HI FY 2017 the growth was 17%.

The Net Profit for Q2 FY 17 has enhanced by 15% when compared to Q2 FY 16 and for H1FY17 Net Profit increased by 13% when compared to H1FY16.

The Net NPA has marginally increased by 4 bps sequentially to 1.63% in Q2 FY2017 from 1.59% in Q1 FY2017 (sequential quarter).

During the period, our Deposits increased by ₹2777 cr from ₹25616 cr to ₹28393 cr, registering a growth of 11% on y-o-y basis.

Similarly, Advances enlarged by ₹3280 cr from ₹18935 cr to ₹22215 cr translating into a 17% growth. Thus, the total business grew by 14% on y-o-y basis. At the close of Q2 FY17 the total Business had crossed the Rs. 50,000 cr mark.

CASA has recorded a growth of 18%, in absolute terms by ₹884 cr from ₹4995 cr to ₹5879 cr. The share of CASA to total deposits which was 20% for Q2FY16 has increased to 21% in Q2 FY17.

CA portion increased by 5% and SA portion by 25% on y-o-y basis.

The Cost of Deposits for Q2 FY17 decreased by 83 bps to 6.86% from 7.69% compared with Q2 FY16 due to reduction in the interest rates offered on deposits. Cost of Deposits for H1FY17 was lower at 6.99% vs 7.78% in H1FY16.

The yield on advances for Q2 FY17 stands reduced to 12.19% as compared to 13% for Q2FY16. The yield on advances was at 12.28% for H1 FY17 vs 12.97 in the last year. The decline in yield is on account of decreasing interest rate cycle and stiff competition in the market.

The Net Interest Income for Q2 FY17 has improved by 61 cr from ₹240 cr in Q2 FY16 to ₹301 cr in Q2 FY17 registering a growth of 25%. NII for H1 FY 2017 improved by 117 cr from 464 cr in H1FY16 to 581 cr in H1 FY17.

The Net Interest Margin for Q2 FY17 has improved by 46 bps to 4.20% compared to 3.74% in Q2 FY16. NIM for H1 FY17 was at 4.14% vs 3.70% in the corresponding period last year. We have consistently maintained the 8 quarter average NIM of around 3.50%.

The non interest income of the bank in Q2 FY17 has improved to ₹104 cr as compared to ₹95 cr in the corresponding quarter mainly on account of securities trading reflecting an increase of 10%. The non-interest income for the H1 FY17 increased by 8% to ₹215 cr from ₹199 cr in H1 FY16.

Further, the treasury profits comprising both domestic and forex segments increased by 44% from 29 cr in Q2 FY16 to 42 cr during Q2 FY17. For the half year the same has increased by

51% from ₹ 60 cr in H1 FY16 to ₹ 91 cr in H1 FY17. The Treasury profit was higher during the last two years because of softening of yields on Government securities across all the maturities. The yield on 10 year Government security has fallen by more than 200 basis points since November 2013. 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 30% in Q2 FY17 to ₹169 cr from ₹129 cr incurred in the corresponding quarter last year. For H1FY17 Operating Expenses increased to 324 cr from 261 cr in H1FY16.

The employee cost increased from ₹ 49 cr to ₹ 77 cr on Q2 to Q2 basis and it increased from 97 cr in H1FY16 to 140 cr in H1FY17. The increase is on account of the wage revision consequent upon the agreement we entered with Staff Union and Officer Association of the Bank effective from 01st July, 2016 onwards.

Thus, Cost to income ratio increased to 41.60% for Q2 FY17 from 38.68% in Q2 FY16. For the half year ended H1 FY17 the ratio is 40.68% as against 39.33% for H1 FY16.

The other operating expenses increased from Rs 80 cr in Q2 FY16 to ₹ 92 cr in Q2 FY17. For H1 FY 16 it was 164 cr vs 184 cr in H1 FY 17. The increase is on account of general increase in rent, lighting, repairs etc.,

The operating profit for Q2 FY17 has increased by 15% from ₹ 205 cr to ₹ 237 cr in the corresponding quarter. Similarly operating profit for the H1 FY17 increased by 17% to ₹ 473 cr from ₹402 cr for the corresponding period last year.

For Q2 FY17, the total provisions made was ₹113 cr, an increase of 16% compared to ₹97 cr in Q2 FY16. Provision for Bad and Doubtful debts increased from ₹45 cr to ₹53 cr for Q2 FY17. Provision for tax decreased to ₹46 cr in Q2 FY17 from ₹48 cr in Q2 FY16.

For the half year ended 2017, the total provisions increased by 23% to ₹225 cr from ₹183 cr in H1FY16. The details of provision made during the quarter is as follows;

Provision for NPA	52.50 cr
Provision for Income Tax	46.00 cr
Provision towards depreciation in Investments(SRs)	15.00 cr
Standard Assets provision	1.75 cr
Write Back provision on Restructured Assets - NPV	-2.25 cr
Total	113.00 cr

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

Provision for NPA	119.50 cr
Provision for Income Tax	87.50 cr
Provision towards depreciation in Investments(SR)	15.00 cr
For investment shifting	0.33 cr
Standard Assets provision	5.17 cr
Write Back provision on Restructured Assets - NPV	-2.25 cr
Total	225.25 cr

PAT for the second quarter thus increased by 15% from ₹108 cr in Q2 FY16 to ₹124 cr in Q2 FY17. For H1 FY17, PAT registered a growth of 13% from ₹219 cr last half year to ₹247 cr.

Return on Assets stands at 1.50% for Q2 FY17 as against 1.45% for the corresponding quarter last year while the ROA for H1 FY17 stood at 1.53% vs 1.51% . The Return on equity stood at 15.28% for Q2 FY17 against 15.07% for Q2 FY 16. Similarly for H1 FY17, ROE stands at 15.66% Vs 15.73% in last year corresponding period.

The Capital Adequacy Ratio (as per Basel III) stands at 14.83% of which core CRAR at 14.35% for H1 FY17.

For Q2 FY17, the gross additions to NPA is ₹ 122 cr compared to ₹98 cr in Q2 FY 16 and ₹101 cr in Q1 FY17. We have recovered a sum of ₹45 cr in NPA accounts during the quarter. For H1 FY17, the total slippages stands at ₹222 cr as against ₹175 cr in corresponding period H1FY16.

Accordingly, the Gross NPA for Q2 FY17 stood at ₹597 cr equivalent to 2.69% of Gross Advances Vs 2.10 % at the close of corresponding quarter last year Q2 FY16. The Net NPA stood at ₹359 cr which is 1.63% of Net Advances Vs 1.36% in the corresponding quarter last year Q2 FY16.

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 0.84% Vs 1.30% in the corresponding period last year. We have collected a sum of ₹ 4.20 cr towards repayments in the restructured standard accounts during the quarter. During this quarter no borrowal accounts slipped into NPA from restructured standard assets.

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

Thank you all!

Over to questions:

Question – 1 – Regarding exposure to Commercial Real Estate & Salary cost:

Our total exposure to CRE is around 5%. The average ticket size is ₹ 24 lakhs and we don't have exposure to large real estate developers like DLF. Ours are granular in size and this mainly comprise of small builders who construct 8 to 15 flats in size.

With regards to increase in salary cost mainly due to increase in wage revision from 1st July 2016 and our average stable quarterly payout will be around ₹ 70 cr from Q2 FY 2017. Apart from this we have provided for Actuarial valuation on Leave encashment and Gratuity which are not substantial. Regarding pension, ours is defined contribution scheme and AS-15 is not attracted.

Question – 2 – Regarding Impact on SME & recoveries due to recent demonetization:

Though the recent demonetization of higher value currencies may result in temporary cash flow problems, we feel it is not going to have any bit impact on our SMEs. The operational inconveniences will be sorted out shortly. The NPAs recovery in Q2 has been the highest when compared to past 7 or 8 quarters. However, the recent development in demonetization could result in some set back and this is not going to affect the slippage side. SME manufacturing is not going to be affected since the sales are mostly routed through accounts.

Question - 3 – Regarding guidance on Credit growth:

The credit growth mainly depends on the performance of the general economy. Our loan growth in Q2 was 17% Y-o-Y basis which is within our estimated growth of 15-18% that we have been sharing with you all along. Going by the current trends, the growth may touch

20% – 22% without much compromise on the quality front. We had a CAGR trajectory 25% upto 2013. However, we don't want to push growth compromising on the quality in the current economic environment.

Question – 4 – Regarding quality of advances & slippages:

Our 10 year average slippage until 2013 was of the order of 1.25% – 1.50% and we had a credit cost less than 50 bps. In the year 2013 the slippages doubled and touched 2.8%. Subsequently it started moderating and currently we have around 2% slippage. The holding of collateral aids better recoveries and the recovery ratio is about 75%. Due to present sluggish economic growth the realization are getting delayed. In our loan book, 1/3 is by way of term loans and 2/3 is working capital both backed by collateral on real estate. For the last 3-4 years, there was a lull in the recovery due to market conditions. We don't have anything to suggest that the present demonetization will have any adverse affect on the recoveries.

Question – 5 – Regarding Q2 slippage:

The Q2 slippage is around ₹ 122 crs in which there are 4 accounts of more than ₹ 10 crs including a textile unit with 15 crs exposure. All the other accounts are granular from various sectors. In Q2, the recovery from NPA accounts was ₹ 45 crs and technical write off was ₹ 32 crs.

Question – 6 – Regarding reduction in Cost / Yield on funds:

The cost of funds reduced from 6.19% in Q1 FY 17 to 5.95% in Q2 FY 17 while the yield on funds contracted less from 9.72% in Q1 FY 17 to 9.60% in Q2 FY 17, resulting in increased NIM of 4.20% up from 4.07% on sequential basis. Also, there was a marginal increase in average CD ratio sequentially which also added to enhanced NIM.

Question – 7 – Regarding increase in operating expense:

The wage revision wef 1st July 2016 resulted in higher salary cost in Q2 FY 17. Consequently, the stable wage cost has increased from ₹ 54 crs to ₹ 70 crs per quarter. Other than this, in Q1 and Q3 there will be ex-gratia payments amounting to ₹ 10 – ₹ 12 crs.

Question – 8 – Regarding Fee income growth:

Our fee income comprises core fee income, treasury income and recoveries from written off accounts. The CEB included in the core fee income is under stress while loan processing charges has been steadily growing. As may be seen CEB income for FY 14 was ₹ 174 crs,

₹ 197 crs in FY 15 and ₹ 211 crs in FY 17. Further, the growth in the fee based income has been gradual.

Question – 9 – Regarding effect of demonetization on Jewel Loans:

Our Gold Loan portfolio is mainly for Agricultural purpose and majority of them comes from rural / semi urban areas. The behavioral pattern depends upon north east monsoon which is relevant in the South. As I have been repeatedly stressing this is not 16% – 18% yield earning portfolio like other NBFCs and it mainly depends on agriculture economy. This has nothing to do with demonetization. Our JL portfolio is not for consumption purpose.

Question – 10 – Regarding view on a stressed account from Iron & Steel in SMA-2 category which you have mentioned in earlier remarks:

I have already shared 2 – 3 stressed accounts over ₹ 50 crs in SMA-2 category over the last two to three quarters coming from Paper & Food Processing. They are still holding and we are continuously watching their performance. The present one is from steel trading and not from manufacturing sector. We are closely monitoring and the borrower has agreed to repay promptly. Still we are hopeful of maintaining the slippage ratio around 2% for FY 2016-17.

Question – 11 – Regarding improvements in recovery front:

In the last 4 – 6 quarters, our recovery is not up to the mark. Now, we are able to see auctions taking place atleast in 2-3 accounts out of 10 resulting in partial payments / recoveries. We are seeing some sort of improvements in recovery process. Whether this will be a sustained happening or one-off event remains to be seen. However, we have been able to recover 70% - 75% with some time delay.

Question – 12 – Regarding view on decreasing SMA-2 accounts as per earlier remarks:

We could see some improvement in the stressed accounts which we discussed earlier in December 2015 con-call. There has been a 25% reduction in SMA-2 accounts and we are confident to achieve slippage ratio around 2% for FY 16-17.

Question – 13 – Regarding possible growth in CASA due to demonetization:

It is true that customers will be depositing excess OHD notes into their CASA accounts. The increase in CASA on this count will be of short term in nature as the customers may once again withdraw cash for their day today needs. In any case, we don’t expect any substantial increase on this count.