CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – MARCH 2017

Dear Investors and analysts, Dr. Kamakodi here.

It gives me immense pleasure to share with you all the audited results for the Year/Quarter ending 31.03.2017. The Board adopted the Audited results at the meeting held today.

When we have shared the annual results on 23.05.16 for FY 2015-16, we had submitted the following expectations for the FY 2016-17.

- ✓ The Credit growth for the FY 16-17 would be 15-18%
- ✓ The slippage ratio for FY 16-17 would be 1.75-2% of the closing credit balance.
- ✓ Profit growth would be 10-12%.
- ✓ We expected an incremental expenditure because of wage revision and hence the cost to income ratio to be in the range between 42% - 43%.

By and large we have achieved most of the parameters except credit growth.

We expected the credit growth for FY 16-17 to be 15% - 18%. In fact, we had recorded 17% credit growth between 30.09.2016 and 30.09.2015. But due to demonetization, we had a negative growth in Q3. Though we caught up in Q4, we could close the FY 16-17 with credit growth of 13%.

We expected the slippage ratio for the whole year to be between 1.75% to 2%. We ended up with 1.99%. As you all know, for a decade or so we had NPA slippage to closing advances hovering around 1.5% till 2013. But slippage ratio almost doubled to 2.81% for FY 14 and moderated to 2.35% for FY 15, 2.02% for FY 16 & 1.99% for FY 17.

The trend in slippage ratio is firm southwards but higher than 1.25% - 1.50% that we had recorded between 2006 to 2013. We expect that the slippage ratio will moderate between 1.75% - 2% for the whole FY 17-18 on as is where is condition. For the past 6 – 8 quarters, we have been sharing with you 2-3 accounts with over Rs.50 cr exposures showing signs of stress. These accounts paid their dues upto March 2017. We expect some of them may become NPA during this year. If more than one of these accounts turn into NPA in the same quarter, there may be some increase in the slippage ratio for the concerned quarter.

During the last concall we said that the SMA position had improved in Q2 and due to demoneitization in Q3 the same has touched the FY 2016 position. But, we could see some positive trend in SMA accounts and the March 2017 position is encouraging. We have to see whether this is one off phenomenon or a firm trend – we have to wait and watch.

Taking all these factors into account, we expect slippage ratio will be between 1.75% to 2% for the current year.

As you might have seen, there is no sale to ARC since FY 2015 and no further restructuring of accounts during the FY 2016-17.

As you all know, four large NPAs accounts sold to ARC in earlier years constitutes 90% of our SRs in FY 2016 and resolution has started in two of the four cases mentioned. About 26.66 cr worth of cash recovery has happened in those cases and repayment schedule goes up to FY 2022. We have made about Rs.43 cr provision in the current financial year for SRs to take care of future expected haircuts. We may make some provisions in the current year also, quantum is not known.

During the last financial year FY 15-16, we had Rs.19.54 cr income from income tax refund, Rs.13.60 Cr from RBI as incentive.

But at the same time, in FY 16-17 we had incurred around Rs.75 cr of incremental salary expenditure because of wage revision and for Security Receipts, we have provided Rs. 43 cr.

Even with this, we could see 22% growth in NII, 19% growth in operating profit, 13% net profit for the FY 16-17 over FY 15-16.

It was supported by 13% credit growth and Rs.108 cr profit that we could book in our treasury book due to favourable yield movements.

Our NIM is still hovering around 4% - 4.25% during FY 2016-17, which is not sustainable.

We have been sharing with you that liquidation of collaterals were not happening in the way we would like them to see. In September and October 2016, we saw some improvement in liquidation of collateral which was nullified in Q3 due to demonetization. Some amount of revival on recovery front started in Q4. During the quarter, we had achieved live recovery of Rs. 56.17 Cr which was the second highest recovery ever reported in the past history of the bank and also the highest recovery in the past 3 years. We also had a recovery of Rs.21.64 cr in TW which was directly taken to income account. If this trend sustains, we hope, this should make up the opportunity like treasury profit which is not going to be available in FY-2017-18 as much was available in 2016-2017.

We shared with you all during Q2 FY 17 that the expectations on credit growth of the system is going to be in single digits as

- ✓ Inflation is very much lower now compared to period when system had 18%-20% growth.
- ✓ Banks controlling 75% of banking system are having NPA issues & are Capital starved. Hence they can’t grow in medium term.

- ✓ There is a trend where large corporate may lookout for bond market as restrictions are expected to be on corporate exposures.

The results of financial year FY 2016-17 is mixed with some banks degrowing while some banks, particularly private banks showing 20%-30% credit growth. Further NPAs have been on the increasing trend among Banks in general.

We are adequately capitalized and have far less NPA problems. We will slowly push for growth. The growth will be at our own pace depending on our comfort with environment. As of now, on as is where is condition, we expect the credit growth for us to be at 15% - 18% range for current year.

Ratios like Return on Assets and cost-to-income ratios are as per our usual record. Return on equity is at 15.48%. Up to FY 2014, we used to have 18-20% ROE, which moderated after our capital raising. The increase in ROE will be seen after we start growing above 20% or so on higher leverage.

We planned to open 50 branches during FY 16-17, but got satisfied with 25 branches due to demonetization. We may open 50-60 branches for the current FY.

After the RBI circular on divergence disclosures, I received few phone calls on that subject. I had to say that the divergence will be there.

In a few cases, where banks have marked them as NPA in the subsequent financial year - Q1 or Q2 but Inspecting team pre-pone the date of NPA – otherwise we may say this as timing difference.

When restructuring fails, as per rule, the date of NPA should be the original date. For example, if the restructuring fails after the due date of balance sheet but before RBI inspection, the NPA date has to be preponed and will result in divergence. There are cases in the banking system where date of NPA is preponed by many years depending on performance of account post restructuring.

Most of these divergence cases will have some subjective elements. When RBI Inspecting team gives there list of divergences, the banks give their own reasons why such accounts are not considered as NPAs by the respective banks.

Generally, it is the practice that in case of any difference of opinion in deciding about the divergence, the observation of the PIO will stand to gain. However, the Bank may submit its view to the PIO while finalizing the inspection which will be considered by RBI at the time of having discussion with RBI, Central office. The RBI has internal processes where banks submissions are evaluated and a few submissions are accepted.

The sum and substance is that you will always have some divergences.

During the FY 16-17, RBI Inspecting team identified a divergence of Rs.82 cr (standard accounts into NPAs) for the FY 2015-16 at the time of Inspection. Out of Rs.82 cr, we had classified Rs.65 cr as NPA in Q1 & Q2 FY 2017 during the normal course of business even before the RBI Inspection started. The balance of Rs.17 cr was classified as NPA in Q3 FY 2017 after the completion of RBI Inspection.

This had been the pattern in previous years also. The percentage divergence will be more than 15% if a few larger accounts are identified and will be lower than 15% if smaller accounts are identified. If we look into the divergence over the past 5-6 years, except in the FY 12-13, in all the other years the average NPA recognition post RBI marking divergence used to be between 15 cr to 25 cr, while in FY 12-13, it was at an elevated level of Rs. 92 cr because of involvement of one large a/c with a balance of Rs.82 Cr.

To sum up,

FY 16-17 had been a decent year. We hope FY 17-18 should also be okay where we make our best efforts to achieve

i) 15 - 18% credit growth

ii) Slippage ratio of 1.75% - 2%.

iii) ROA, ROE, cost to income ratio at the current level.

iv) Some profitability pressure will be there because of possible non availability of profit booking opportunities in treasury book.

v) GST is also expected to increase some pressure on expenditure side as Banks can take only 50% benefit on expenditure done towards unregistered entries. The expenditures like rent will get affected because of this.

We hope to see liquidation of collateral to reduce NPA levels will get better from this year and from FY 18-19, NPA ratios should start showing declining trend. If recovery trend firms up it could ease some profitability pressures through lesser provisioning requirements. I repeat, this is "our hope".

The Bank has a dividend paying track record of over 110 continuous years. The dividend payout has also grown over a period of time.

The Capital adequacy regulations have become increasingly stringent and hence, while the bank is paying dividends, on the other side it is forced to go for equity dilution on and off to fulfill capital adequacy requirements. Keeping that in mind the Board has recommended 30% cash dividend to shareholders for FY 2016-17 against 120% dividend paid last year. At the same time the Board had recommended to allot bonus shares to existing share holders – one share for every 10 shares held. All subject to shareholders approval. The 30% dividend is payable on the enhanced equity after the capitalization of reserves as mentioned above.

Based on the recommendations of the Board, the Reserve Bank of India has approved the extension of my tenure as the CEO of the Bank for another 3 years ending 30.04.2020.

Details of the working results:

Our Board has adopted the Audited Financial Results for the said period today, the details of which have been already updated in our website, published and circulated.

Let us get into the details of the fourth quarter and Yearly results:

The Bank has shown a growth of 11% in Operating profit in Q4 FY 2017 over the corresponding period and for the FY 2017 the growth was 19%.

The Net Profit for Q4 FY 17 has enhanced by 15% when compared to Q4 FY 16 and for FY 17 Net Profit increased by 13% when compared to FY 16.

The Net NPA has marginally decreased by a basis point sequentially to 1.71% in Q4 FY2017 from 1.72% in Q3 FY2017 (sequential quarter).

Coming to the Business growth, our Deposits increased by Rs.2958 cr from Rs.27158 cr to Rs.30115 cr in FY 2017 thereby registering a growth of 11%.

Similarly, Advances increased by Rs.2859 cr from Rs. 21253 cr to Rs.24112 cr translating into 13% growth. Thus the total business grew by 12% to Rs.54228 Cr for FY 2017 from Rs.48411 Cr last year.

CASA has increased by 27% by Rs.1506 cr from Rs.5533 cr to Rs.7039 cr. The share of CASA in total deposits was 23%. While CA increased by 26%, SA grew higher at 28%.

The Cost of Deposits for FY 17 decreased by 80 bps to 6.82% from 7.62% compared with last year. Cost of Deposits for Q4 FY 17 was 6.62% Vs 7.39% in last year Q4.

The yield on advances for FY 17 stood at 12.10% as compared with 12.83% in FY 16. For Q4 FY 17 it stood at 11.86% vs 12.59% on account of stiff competition.

The interest yield on Investments has decreased by 22 bps to 7.23% for FY 17 as compared to 7.45% for FY 16 and in Q4 FY 17 it decreased by 28 basis points to 7.20% from 7.48% in Q4 FY 16.

The Net Interest Income for Q4 FY 17 stood at Rs.311 cr as against Rs.264 cr in the corresponding period thereby registering a growth of 17%. The NII for the whole FY 17 grew by 22% from Rs. 981 cr to Rs. 1199 cr. The Net Interest Margin for Q4 FY 17 stood at 4.20% vis-à-vis 3.96% in Q4 FY 16 and for the whole FY 2017 NIM stood at 4.17% as compared to 3.81% for FY2016.

The other income of the bank in Q4 FY 17 was Rs.126 cr as compared to Rs.107 cr registering a growth of 17%. Likewise for the whole year the same is stood at Rs.484 cr Vs Rs.410 cr last year recording a growth of 18%. The increase was mainly on account of securities trading, improvement in collection in written off accounts and insurance commission. During the FY 2016-17, the yield on GOI securities moved southwards. The yield on 10 year benchmark moved from 7.41% to 6.69% on account of rate cut measure and accommodative measures by RBI during the first half of FY 2016-17. During the month of November 2016, it went down sharply and touched a low of 6.12% on account huge inflow of funds into the banking system on the demonetization announcement made by GOI. Anticipating that the drop in yield will be temporary and RBI may step in to suck out the excess liquidity, securities under HTM were sold and profit of Rs. 46 cr was earned in Q3 as against Rs. 19 cr in Q2. As anticipated, the yield reversed its course and went up to 6.95% after RBI took measures to suck out the excess liquidity as also on change in RBI's policy stance from accommodative to neutral.
CEB income for Q4 FY 2017 increased from Rs.53 cr to Rs.58 cr and for the whole year the same has increased from Rs.210 cr to Rs.218 cr.

Operating expenditure has increased by 28% in Q4 FY 17 from Rs.148 cr to Rs.189 cr and for whole year it rose from Rs.558 cr to Rs.689 cr registering an increase of 24%. In FY 2017 the establishment expenses increased from Rs.213 cr to Rs.298 cr. The increase is mainly on account of salary revision made in July 16 to employees as we have been informing in our concalls. Further, a provision of Rs. 12 cr was made towards ex-gratia payment for staff members. The other operating expenses increased from Rs.345 cr to Rs.392 cr which was due to normal increase in expenses like Rent, Lighting, Printing & Stationery, Telephones and Repairs & Maintenances etc.,. (R&M include - AMC charges/Batteries/general repairs/electrical works in branches).

Thus, the Bank has recorded a growth of 11% in Operating profit in Q4 FY 2017 over the corresponding period of 2016. In absolute terms the Operating profit increased from Rs.224 cr to Rs.248 cr. The growth in Operating Profit for FY 17 was 19% higher from Rs. 833 cr to Rs. 994 cr. The operating profit to NII constitutes 83%. In other words the other income including commission, exchange, brokerage, Treasury, write back of written off assets & other misc income takes care of 40% of non interest expenditure.

For Q4 FY 2017, the total provisions increased by 6% from Rs.112 cr to Rs.119 cr. The total provisions for FY 17 were increased by 26% from Rs.389 cr to Rs.491 cr. We have provided Rs. 47.50 cr towards taxation in Q4 FY 17 as against Rs.41 cr for the corresponding period and for FY 2017 the same was Rs.190 cr as against Rs.158 cr last year. Tax provision to PBT in FY 17 was at 27%.

The details of provision made during the quarter Q4 FY 17 is as follows;

Provision for NPA	45.00 cr
Provision for Income Tax	47.50 cr
Provision for standard assets	5.23 cr
Provision for depreciation on investments incdg SRs	23.15 cr
Provision for other losses – write back	-2.12 cr
Total	**118.76**

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

Provision for NPA	251.50 cr
Provision for Income Tax	190.00 cr
Provision towards depreciation in Inv incl SRs	48.65 cr
For investment shifting	0.33 cr
Standard Assets provision	8.00 cr
All other provisions – written back	-7.51 cr
Total	**490.97 cr**

The Net Profit for the fourth quarter thus has increased by 15% from Rs. 112 cr to Rs. 129 cr. For FY 2017 the same has increased by 13% to Rs.503 cr from Rs.445 cr last year.

Return on Assets for the year ended FY 17 remained at 1.50% and in Q4 the same was 1.50% vs 1.46%. The Return on equity stood at 15.26% for FY 2017 as against 15.60% for FY2016 and 14.97% for Q4 FY 17 vs 14.94% for Q4FY16.

Cost to income ratio increased to 40.94% for FY 17 from 40.10% in FY 16. The increase was on account of wage revision during the year. Similarly the cost to income ratio stood at 43.25% for Q4 FY 17 as against 39.73% last year Q4 FY 16.

The Gross NPA ratio for FY 2017 decreased by 15 bps from 2.98% in Dec 2016 to 2.83% in March 2017. During Q4 the bank has recovered Rs.56 cr in Q4 which is the highest in the last 3 years. Because of that, the Net NPA to Net advances decreased marginally by 1 bps from 1.72% in Dec 2016 to 1.71% in March 2017.

During the year we have not sold any assets to ARCs. Of the total outstanding of Rs. 373 cr in SRs as at 31.03.2016, collection received during the year was Rs. 26.66 cr and the outstanding in SRs as at the end of 31.03.2017 was Rs. 347.17 cr. Based on the valuation, the NAV loss provisions works out to Rs. 42.88 cr for which we have made full provision.

We have not restructured any accounts during the year and the outstanding restructured assets to Gross advances stood at 0.56% Vs 0.96% in the corresponding period last year. We have collected a sum of Rs. 61.10 cr towards repayments in the restructured standard accounts during the quarter. During this quarter no borrowal accounts slipped into NPA from restructured standard assets._During the quarter 2 restructured accounts were closed amounting to Rs. 57.24 cr.

Question & Answers:

Question : What are all the segments that driving growth in FY 2016-17 and your expectation for FY 2017-18? Also, when you are expecting NIM compression?

Answer:

Regarding the growth, we are not changed our strategy to go for Corporate / Large ticket size advances. We want to continue the same strategy by way of lower ticket advances. The growth comes mainly from migration of customers from the Public Sector Banks.

On NIM's compression, it is dependent on interest rate movements. Though we are operating in a decreasing interest scenario, 10 year GOI bond yields have recently moved up. Hence it is not clear as to the movement of interest rate. Based on the general perception, we are expecting compression in NIM should happen in the current FY 2017-18.

Question: What is the total RWA? What is the provision for SR and the outstanding under SMA-2 amount?

Answer:

The total RWA under Basel III as on 31.03.2017 is Rs. 23001 cr. Totally, we have provided Rs.43 cr towards SR and this is provision is kept separately for any future drop in NAV. The balance outstanding in SMA-2 accounts of over 5 Cr as submitted to RBI stands at Rs.647 Cr which is 2.68% of the total loan book. Out of the above outstanding of Rs. 647 Cr that includes all facilities extended to the same borrower, an amount of Rs. 196 Cr are delayed portion (SMA-2 over 5 Cr accounts) and remaining Rs.451 Cr are regular and are included as per RBI guidelines.

Question: What is amount of slippage in Q4 FY 2017? Is there any big ticket accounts included? When you will get the benefit of deposit repricing?

Answer:

The slippage for the current quarter is Rs.139 cr and there is one account slipped to NPA to the tune of Rs.18 crs from Iron & Steel sector. The balance are all small and granular. 95% of our deposits are in one year time bucket and in a year's time we get the full benefit of re-pricing.

Question: In your total stressed assets, what is the share of textiles? Is there any exposure to 5/25 and SDR? What is your expectation on Fee income growth for FY 17-18?

Answer:

There is no significant textile exposure in our stressed assets. Based on the price revisions along with appreciation / depreciation of rupee as well as forward contracts entered by the exporters we don't anticipate any major weakness in that sector. We don't have any exposure to 5/25 and SDR. Our fee income is mainly based on core business and hence it is dependent on our advances growth. We don't anticipate any major change in our fee income.

Question: What is the outstanding in TW accounts?

Answer:

The total outstanding in TW accounts is around Rs.300 crs. Normally we are able to 70% - 80% of the loan valtue as all these loans are backed by collaterals in the form of Plant & Machinery, Buildings and House properties of the borrower. Though there is a delay in recovery process, we are able to recover with a lower loss given default.

Question: There is an increase of 40% in the establishment expenses which include any one off? Also, what is the reason for increase in other operating expenses? What is your view on credit growth for FY 2017-18?

Answer:

The revision of salary took place wef 1st July 2016 based on agreement with the Staff Union & Officer Association for the next 5 years involving one time increase around 25% is the main reason for increase in establishment expenses. Also, the establishment charges includes an amount of Rs.12 cr as provision for ex-gratia. Regarding increase in other expenditure, it includes normal increase and AMC charges. We anticipate a credit growth of 15% - 18% for the current year.

Question: The biggest slippage is from which sector and what is the quantum? You have mentioned Rs.17 cr of divergence accounted in Q3 FY 2017 and is there any addition due to divergence in Q4 FY 2017. What is the position regarding restructured accounts? Also, what is the watchlist for FY 2017-18?

Answer:

The biggest slippage is from Iron & Steel sector of ` 18 cr. Wrt to divergence, there is addition during Q4 FY 17 since all the accounts mentioned by RBI have already been included in Q1, Q2 & Q3 FY 2017. As on 31.03.2017, there are 19 accounts aggregating to Rs.135 cr is in restructured category. During Q4 FY 2017, there is a repayment of Rs.22 cr from TANGEDCO which represented restructured portion out of the total outstanding of Rs.57 crs. Hence, the repayment of 22 cr resulted in reduction of Rs.57 crs from the restructured portfolio. We don't expect similar reduction in the restructured category since the other loans are small in nature. After completion of two years of successful repayment any restructured account gets out of that list. Regarding the watch list account, for the past 6 – 8 quarters, we have been uncontinuously discussing about 2-3 accounts with over Rs.50 cr exposures showing signs of stress. These accounts paid their dues upto March 2017. These accounts are continuously monitored and are in watch list.

Question: Have you made any revision in Service Charges? What is percentage of PCR?

Answer:

We have revised our service charges wef April 2017 without anticipating the effect of GST. However, the other banks revised their charges significantly during the month of April. Accordingly, we are proposing to revise our charges from 1st July 2017. The provision coverage ratio stood at 61% for 31.03.2017.

Question: Generally when the divergence will be informed to the Bank? What is the outlook on credit growth wrt Tamil nadu and Gold loan? Have the borrowers started availing the unutilized limits?

Answer:

For our Bank, RBI inspection takes place in the 3rd quarter and the final report will be made available in 4th quarter. The said report including divergence mentioned will be placed before the Board for necessary action. The loan growth outlook including gold loans remains the same in Tamil nadu. The utilization of sanctioned limits has improved marginally in Q4 FY 2017.

Question:

Out of Rs.50 crs of written off, Rs.47 crs pertaining to TW and what is the balance amount of Rs.3 cr?

Answer:

The balance of Rs.3 cr represents normal write-off on account of compromise / settlement etc.