CITY UNION BANK LIMITED, ADMIN OFFICE, KUMBAKONAM

CONCALL TRANSCRIPT OF OUR EARNIGS CALL – SEPTEMBER 2019

Good afternoon to all, Dr. Kamakodi here.

Wish you all belated Diwali wishes !

Hearty welcome to all of you for this conference call to discuss Q2 and H1 FY 2020 financial results of City Union Bank. The Board of Directors has 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 Q & A. Hope you all received the copy of the presentation.

Incorporated on 31.10.1904 as Kumbakonam Bank Limited, our Bank commenced operations on 01.11.1904. Bank completed its 115 years of service with uninterrupted track record of dividend payout and profitability, celebrated its 116th foundation day on 31.10.2019. To commemorate this 115 years of service, the Bank is having a function on 23.11.2019 at Chennai and Smt. Nirmala Seetharaman, Hon'ble Finance Minister has agreed to be the chief guest. We welcome all of you to participate in the function. We thank all the stakeholders for their wishes and continuous support.

The performance highlights of the Q2 / half year ended FY 2020 is as given below;

- Deposits growth stands at 17% while CASA growth stands at 22%. Hence CD ratio has dropped despite reduction of term deposit rates.
- Advances growth rate for Q2 is 12% YoY. During the earlier concalls we shared our expectations of growth between 15% and 18%. Based on the external sentiments we are not pushing hard for growth. We don't think pushing for growth at current times is in tune with our ethos. We are keeping our underwriting standards reasonably tight to ensure not to get into problems in the future. Being a very very long time player, a few percentage point lower growth will not alter anything for us materially.

- Thus, business grew by 15%
- The Operating profit improved by 17%
- Net profit grew by 15% on account of improved recovery from TW accounts and growth on profit from Treasury

By and large overall asset quality is on expected lines. Slippage ratio looks optically higher by 10 – 20 basis points because of lower growth / denominator, but follows established trend. I have been getting many questions from investors on the fear of asset quality of SMEs on this poor economic scenario. Contrary to our expectations, the conditions in Tamilnadu is not all that bad on as is where is condition. I am not sure but the reason could be that Tamilnadu has recorded second highest GDP growth with over 8% among states in the Country.

Based on our discussion with our SME Borrowers, what we understand is

- ✓ Their head is above water
- ✓ They don't have any worry about viability of their business.
- ✓ But most of them have tightened their belts and not investing now for growth.
- ✓ We could see reductions in Cash Credit utilization.
- ✓ They have some concern about next 2 – 3 quarters but feel things will improve beyond that.

Overall things are not as bad as it is being perceived from outside based on what we hear in media or even social media.

At the same time it is time to wait for proper growth opportunities and not a prudent time to accelerate growth with an eye on downward risks. On one side we feel it is not the time to focus on accelerating growth rate, but focus should be on quality. At the same time, if the growth rate reduces it leads to other issues. Slippage ratio, gross NPA and net NPA percentage looks higher as denominator is less. Your Net interest income and operating profit growth looks lower.

There is no undue spike in SMA proportions and we are closely watching the developments. The paper mill what we were discussing during earlier conversations survived Q2 but may not survive Q3.

NIM for Q2 dropped by 20 points to 3.91% and for H1 stands at 4.01%. We have been expecting NIM drops for many quarters. It is because of combination of both yield drop and CD ratio. CD ratio dropped to 81% from high of 86% in Q4 2019. We are trying our best to increase CD ratio and have reduced term deposit rates also. But still term deposit accretion is not slowing down. Credit growth also needs to pick up.

Recovery of NPA by auctions are showing minor improvements but not to that extent we want. The recovery from live accounts remain flat at around Rs. 127 crs as compared to recovery in TW accounts which almost doubled from Rs. 33 crs in H1 FY 2019 to Rs. 65 crs in H1 FY 2020. This is the first time the bank could see a recovery of 100 cr + in a quarter (Q2 FY 20) with ` 79 crs in Live accounts and ` 33 crs in TW accounts.

Favorable yield movements in domestic Treasury has helped us to make a profit of Rs. 57 crs during Q2 FY 2020 as compared to Rs. 30 crs in Q1. The profit from trading in the whole FY 2019 was Rs. 33 crs.

Operating expenses increases as usual and hence cost to income ratio shows upside when compared to Q1 FY 20. Cost to income ratio stands at 42.87% for Q2 and 41.19% for first half 2020. We had about 45%+ cost to income ratio for two quarters during FY 2013-14 but it subsided subsequently. During the current quarter we had Rs.78.85 Cr of profit from treasury. We are not sure how much profit we are going to make in Q3. Write off recovery also plays a major role in determining cost to income ratio. We are working hard to maintain the Cost income ratio as per our trajectory levels and if anything goes out of our expectations, it will have some spike in the cost to income ratio.

But if God closes one door, he opens another door. The reduction in Income Tax rate is God sent and we got the benefit of Rs.37 Cr towards current tax for the Half year and Rs.13 towards Deferred Tax Liability which has been recognized during the quarter.

During our last concall we informed about completion of resolution in one major SR account for which repayment will commence from 3rd quarter. As you all know top 4 accounts take care of around 90% of our total Security Receipts. We have received a sum of Rs.10.48 Cr during Q1 FY 20 and Rs.10.30 crs in Q2 FY 20. Since the repayment terms goes up to 2022, we expect there will be cash flows continuously. The outstanding SR as at 30.09.19 stands at Rs. 303 crs as compared to Rs. 324 crs at the end of March 2019.

ROA stands at 1.62% for Q2 & H1 FY 20 and we should be on track on ROA front in the established territory of 1.5 – 1.6 range and return on equity as usual is 15+ range even after taking into account various potential shocks including External bench marks for floating rates.

As told in the earlier quarters, we are recommending to our SME customers to use the RBI dispensation. So far we have restructured 121 accounts amounting to Rs. 117 crs as at 30.09.2019. No account slipped to NPA during Q2 FY 2020.

To sum up,

We hope overall we should be able to maintain our ROA and ROE in the current band even if the growth rate is muted and in NPA also by God's grace should be at the current level.

With this I conclude and over to CFO Mr. Ramesh to run through the numbers.

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 FY 20 / H1 FY 20.

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

The Operating profit has increased by 17% in both Q2 & H1 FY 20. In absolute terms, the operating profit stood at ` 346 crs and ` 698 crs for Q2 FY 20 / H1 FY 2020 as against ` 296 crs and ` 595 crs in corresponding period of FY 2019.

The Net profit has improved by 15% in both Q2 & H1 FY 20. In absolute terms, the Net Profit stood at ` 194 crs and ` 379 crs for Q2 FY 20 / H1 FY 2020 as against ` 168 crs and ` 330 crs in corresponding period of FY 2019.

The Gross NPA has increased by 7 bps sequentially and stood at 3.41% against 2.95% for FY 2019. The Net NPA remain flat at 1.90% sequentially and in Q2 FY 2020 as against 1.69% in corresponding period last year.

During the period, our Deposits has increased by Rs.5917 cr from Rs.34534 cr to Rs.40451 cr, registering a growth of 17% on y-o-y basis. Similarly, Advances enlarged by Rs.3494 cr from Rs.29785 cr to Rs.33279 cr translating into a 12% growth. Thus, the total business grew by 15% on y-o-y basis.

CASA has recorded a growth of 22%, in absolute terms by Rs.1824 cr from Rs.8164 cr to Rs.9988 cr. The share of CASA to total deposits which was 24% for Q2 FY19 has improved to 25% in FY 2020. CA portion increased by 16% and SA portion by 26% on y-o-y basis.

The Cost of Deposits for Q2 FY 20 increased by 18 bps to 6.25% from 6.07% compared with Q2 FY19. Cost of Deposits for H1 FY20 was at 6.24% vs 6.11% in H1 FY19. Sequentially the cost of deposits have come down to 6.24% as compared to 6.25% in Q1 FY 2020. The COD as at FY 2019 was at 6.17%. The CD ratio has come down to around 82% against 84% earlier. As such we are not pushing for deposits and when credit growth picks up we shall go for higher rate on deposits.

The yield on advances for Q2 FY 20 stand decreased to 10.76% as compared to 10.86% in Q2 FY19. The yield on advances remain flat at 10.86% for H1 FY20 & FY 19. The decline in yield is on account of competition in the market. The YoA for sequential quarter Q1 FY 2020 was at 10.97%.

The Net Interest Income for Q2 FY 20 has improved by Rs.14 cr from Rs. 398 cr in Q2 FY19 to Rs. 412 cr in Q2 FY20 registering a growth of 3%. NII for H1 FY 2020 improved by Rs. 55 cr from Rs. 773 cr in H1 FY19 to Rs. 828 cr in H1 FY20.

The Net Interest Margin for Q2 FY 20 has declined to 3.91% from 4.32% in Q2 FY19 which is in line with our expectation of contraction in our concalls and also due to reduction in CD ratio from 86% to 82%. NIM for H1 FY 20 was at 4.01% vs 4.28% in the corresponding period last year.

The non interest income of the bank in Q2 FY20 has increased to Rs.195 cr as compared to Rs.119 cr in the corresponding quarter mainly on account of improvement in profit on trading of securities and recovery from written off accounts. The treasury profits comprising both domestic and forex segments improved by 275% from Rs. 21 cr in Q2 FY19 to Rs.79 cr during Q2 FY20. Suit recoveries also improved to ` 33 crs in Q2 FY 2020 as compared to ` 18 crs in FY 19.

The non interest income for the half year has increased by 45% from Rs.248 cr in H1 FY 19 to Rs.358 cr in H1 FY 20. Income from domestic and forex treasury increased from Rs.41 crs in H1 FY 19 to Rs.123 crs in H1 FY 20. Also, the income from written off accounts increased to ` 65 crs in H1 FY 2020 from ` 33 crs in H1 FY 19.

Operating expenditure has increased by 18% in Q2 FY20 to Rs. 260 cr from Rs. 221 cr incurred in the corresponding quarter last year. For H1 FY20 Operating Expenses increased to Rs. 489 cr from Rs.425 cr in H1 FY19. The employee cost increased from Rs. 93 cr to Rs. 113 cr on Q2 to Q2 basis and it increased from Rs. 180 cr in H1 FY19 to Rs. 213 cr in H1 FY20. The other operating expenses increased from Rs.128 cr in Q2 FY19 to Rs.147 cr in Q2 FY20. For H1 FY 19 it was Rs. 245 cr vs Rs. 276 cr in H1 FY 20. The increase is on account of general increase in rent, taxes (GST), lighting, repairs etc.

Thus, Cost to income ratio increased to 42.87% for Q2 FY20 from 42.71% in Q2 FY19. For the half year ended H1 FY20 the ratio had slightly declined to 41.19% as against 41.66% for H1

FY19 on account of improved treasury income. During this period the other incomes like IT refund, PSLC income were not available.

Accordingly, the Operating Profit for Q2 FY 20 improved by 17% to Rs.346 cr from Rs.296 cr in Q2 FY 19. For H1 FY20 the same has improved by 17% from Rs. 595 cr to Rs. 698 cr in the corresponding period last year.

For Q2 FY20, the total provisions made was Rs.153 cr an increase of 20% compared to Rs.128 cr in Q2 FY19. Provision for Bad and Doubtful debts stands increased from Rs.47 cr to Rs.98 cr for Q2 FY20 on account of increased in slippages.

For the half year ended 2020, the total provisions increased by 20% to Rs.319 cr from Rs.266 cr in H1 FY19. The details of provision made during the quarter Q2 FY 20 is as follows;

Rs. in Cr

Provision for NPA	98.00
Provision for Income Tax	45.00
Provision for Std Assets	9.00
Provision towards Restructured accounts	0.75
Provision towards Others – Un-hedged exp	0.20
Total	**152.95**

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

Rs. in Cr

Provision for NPA	242.00
Provision for Income Tax	95.00
Provision written back – investment provision	(24.00)
Provision for std assets	5.25
Provision for restructuring	0.75
Provision - Others	0.20
Write back of country risk provision	(0.50)
Total	**318.70**

Thus, PAT for the second quarter thus increased by 15% from Rs. 168 cr in Q2 FY19 to Rs. 194 cr in Q2 FY20. For H1 FY20, PAT registered a growth of 15% from Rs. 330 cr last half year to Rs. 379 cr.

Return on Assets remain flat at 1.62% for Q2 FY20 / Q2 FY 19 while the ROA for H1 FY20 stood at 1.62% vs 1.63% for the corresponding period last year. The Return on Equity stood at 15.18% for Q2 FY20 against 15.20% for Q2 FY 19. Similarly for H1 FY20, ROE stands at 15.21% Vs 15.29% in last year corresponding period.

The Capital Adequacy Ratio (as per Basel III) stands at 15.49% of which core CRAR at 14.96% for H1 FY19.

For Q2 FY20, the gross additions to NPA is Rs. 200 cr compared to Rs. 136 cr in Q2 FY 19 and Rs. 200 cr in Q1 FY20. We have recovered a sum of Rs. 79 cr in NPA accounts during the second quarter. For H1 FY 20, the total slippages stands at Rs. 400 cr as against Rs. 262 cr in corresponding period H1 FY19 on account of slippage of few large accounts.

Accordingly, the Gross NPA for Q2 FY20 stood at Rs. 1135 cr Vs Rs. 1076 cr Q1 FY20 and GNPA remain slightly increased to 3.41% as compared to 3.34% sequentially. The Net NPA stood at Rs. 624 cr which is 1.90% of Net Advances Vs 1.69% in the corresponding quarter last year Q2 FY19. We have sold an account to ARC to pre pone the recovery by one year which was under OTS and where the repayment was as per the terms provided.

During the quarter 23 accounts were restructured amounting to ` 49 crs taking the total accounts to 121 accounts with o/s balance of ` 117 crs as at H1 FY 2020. The outstanding standard restructured accounts to Gross Advances stood at 0.35%. No account slipped to NPA during Q2 FY 2020.

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

Thank you all!

Over to questions:

Darpin Shah, HDFC Securities

Q: Your slippages have been in the range of Rs200-220Crs in last few quarters. Any guidance on this?.It is coming only from SME or MSME segments or retail and Agri also ?

A: Nothing specific from any particular sector. We had discussed for our slippage ratio of ~1.9-2% on closing advances at the beginning of the year. The slippages will be in this range for may be 1-2 quarter. We have to see the behavior of general economy to direction of slippages.

Q: So, the slippages will be in this range only in next two quarters and that includes the paper account that you mentioned earlier?

A: There may be spike of 10-15 Crs in next quarter if the paper account gets added. Apart from paper account, we don't have any account having more than Rs.50 Cr exposure.

Q: We have not seen any deterioration in SME book?

A: It is the same like what we have been saying around 5%. Trends had been typically, on annualized basis slippage percent on closing advances divided by SMA-2 roughly used to be 1/3rd and we are seeing the same 5-5.5% quarter. There is no dip in the trend so far.

Q: Sharp rise in employee cost? Any one off there ?

A: No one off. Minor increase due to provision for leave encashment on actuarial calculation. Apart from these, normal increase due to increased headcount and increased salaries.

Q: Where do we see NIMs now ?

A: We are also keeping our fingers crossed on this. We have one lever - CD ratio. If I repay Rs.4,000Crs of deposit today, my NIMs will automatically increase and come back to earlier levels of two quarters back. Unfortunately, can't do that. We are also simultaneously reducing rate of interest on deposit. During March this year, we wanted ample liquidity with us due to NBFC crisis. However, now even after decreasing interest rate on deposit, it is not going away.

This is the lever we have. So, reduction in NIM is a function of CD ratio and let's sees how it pans out going forward.

Renish Bhuva, ICICI Securities

Q: Incremental growth side–We are growing in CRE/Infra/NBFC more aggressively. Although, quantum is low in these segment but what gives you the confidence to grow in this segment?

A: As you rightly said, the quantum is low. However**,** we take call on borrowers not on sector classification. We are trying to tap on one opportunity – Gold loan. The interest subvention offered by PSU is for crop loan not for Gold loan. So, we are focusing on this.

Q: There has been increase in CRE exposure. Why ?

A: We answered it last time as well. The increase in CRE exposure is due to regulatory changes/reclassification. These are not builder loans but business loan/Cash credit loans given as overdraft against collateral.

Q: Opex – Not only employee expense but other opex has also has increased sharply?

A: AMC cost and depreciation on IT plays some role there but opex cost growing 10-12% is given. 1-2% can be the difference but we are keeping a close watch on this.

Q: So, It will normalize in second half?

A: Yes, it cannot come down drastically but some moderation in next year is expected.

Q: Why we are not growing more aggressively in Tamilnadu considering its huge contribution in GDP?

A: Growth number is derived number for us. We are not totally pessimistic on growth and at the same time we are also not gung-ho about it. We don't want to give guidance on aggressive loan growth and then come back with asset quality issue 2-3 quarters down. Let things settle down. We don't have comfort for high growth at this point of time. We have been long term player and few percentage points here and there does not matter much.

Q: Do you see growth coming down for your competitors in Tamilnadu?

A: Our Immediate peer KVB reported only 2% growth. Bigger bank HDFC bank has reported good growth but mainly on consumer side. We have also seen good growth in corporate sector. We are not present there. We are playing with boundaries and try to get the best results.

Aman- Haitong Securtities

Q: PSU banks are facing issue in TN. Post-merger, competiton should go down. What are the drivers of growth according to you ?

A: We are looking for Npa recovery 150 Crs (currently 110-120 Crs). This is one driver. At the same time, we have tightened underwriting process so that we are not losing on asset quality to gain higher growth rate.Whenever you grow more than Industry, you will be in trouble tomorrow.

Q: Any market share gain opportunity in Tamilnadu due to PSU problem ?

A. We are already gaining and the quantum is less.

Jai Mundra – B&K

Q: There is huge treasury gain despite having low AFS book. Why?

A: The bulk of gain has been booked from HTM book. We are running an appreciation of Rs.100 Crs. As per Regulatory - When we liquidate more than 5% of HTM book, we have to show MTM at the end of FY. If Interest rate goes up, you will be losing opportunity.

Q: So, some of the treasury book gain has come from selling the HTM book?

A: Yes

Q: How much % of total loan linked to external rate& does you include Term loan/CC/WC to external benchmark?

A: Micro and small, Housing and personal need to be linked to external – Around 45% to 50%. Progressively, TL, WC and CC linked to external benchmark. If existing customer demands for external benchmarked loan, we have to give it. We need to see impact in increasing interest rate cycle that needs to be seen.

Q: Any comment on health of Textile Industries particular in TN?

A: We discussed about this in last concall as well. Bulk of larger textile problem came due to balance sheet issues of large entities. After GST or even due to pollution issues, textile did not create any bigger NPA for us. It has not been a bigger problem for us.

Q: Any stress in MSME/SME?

A: 1 day or 2 day delay is part of the business. We only discuss about NPA not SMA. SME will have short term credit mismatch. One more thing, RBI inspection for this year is over and there is no divergence reported.

Rakesh Kumar, Elara Capital

Q: This quarter we have not booked any profit from PSLC. What is the likely amount to be booked in coming quarter?

A: I don't have the number right now. Moving forward, we have to sell based on the excess in hand after our requirement of PSL.

Q: How much recovery is expected in coming quarters on SR front?

A: Top 4 accounts which accounts of 90% of SR account has been resolved and cash flow has been started. In six months, there has been reduction by 8% and repayments time has gone to 2022. So, we feel there will be continuous cash flow and there will not be any requirement for Incremental provisioning. Before the end of current FY, overall outstanding should come down to below Rs 250 Crs.

Q:. What is the total written off pool?

A: About Rs.600 Crs

Prasheel Shah, Cap Grow Capital

Q: Slippages have gone up. Any comment on this?

A: We expect same kind of slippages in next quarter as well. This has been as per our expectation.

Q: Any comment on recoveries?

A: We are not in IBC market. We are under SARFAESI in which physical possession of property needs to be taken and then auction the property. This comes under District magistrate or District collector. After so many years, some decision making from Government is coming. So, for recovery, Market and Government both need to come together. There are lots of operational issues as well. My expectation is recovery per quarter should be Rs.150 Crs for which we are putting our best efforts.