

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pvt. Sector Bank	Rs.236.7	Buy at LTP and add further at Rs.212	Rs.257	Rs.278	2 quarters

HDFC Scrip Code	CSBBAN
BSE Code	542867
NSE Code	CSBBANK
Bloomberg	CSBBANK IN
CMP Mar 04, 2021	236.7
Equity Capital (RsCr)	173.46
Face Value (Rs)	10
Equity Share O/S (Cr)	17.35
Market Cap (Rs Cr)	4,105.7
Book Value (Rs)	103.9
Avg. 52 Wk Volumes	328429
52 Week High	269.9
52 Week Low	95.0

Share holding Pattern % (Dec, 2020)	
Promoters	49.74
Institutions	13.17
Non Institutions	37.09
Total	100.0

Fundamental Research Analyst

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Our Take:

CSB Bank is a century young private sector bank in India having a strong base in Southern India. In October 2018, the bank partnered with the Toronto-based Fairfax group (FIHM), which holds around 49.7% in the Bank as on December 31, 2020. The company aims to fuel its future lending growth by leveraging its expertise in retail, gold and SME. CSB is having one of the highest proportion of gold loans to its total advances (40% of advances) in the banking industry and this untapped potential allows it to enhance this proportion even further on a growing balance sheet. Gold financing for CSB is a high yielding business which is fully secured against gold which is a very liquid asset. Its total business as on Q3FY21 stood at Rs. 31,800Cr. It has 5 bancassurance tie-ups with industry leaders.

CSB in the past has been plagued by higher stress largely from Corporate (23% of advances as on Q3FY21) & SME segment (15% of advances as on Q3FY21). GNPA ratio was as high as 7.9% in FY18. With the recent capital infusion by promoter, bank has been able to write-off bad loans which led to significant improvement in asset quality. As of Q3FY21 GNPA & NNPA ratio stands at 1.77% and 0.68% respectively. Provision Coverage Ratio stood at 91.03%. CSB's capital position has been significantly strengthened post capital infusion from FIHM and funds raising through IPO.

CSB's key managerial personnel, member of board & other senior employees have strong reputation within the industry, extensive industry relationships and wide-ranging experience in the banking and finance industry, which could help the bank grow and evolve.

Valuations & Recommendation:

The company has posted excellent 9MFY21 numbers. We have envisaged growth of 19% CAGR in NII and 38.8% CAGR in Profit before tax over FY20-23E. Net profit is expected to grow up to Rs. 269 Cr in FY23E from mere Rs.13 Cr (lower base) in FY20. Advance growth is estimated at ~17.8% CAGR over the same period. NIM is estimated to remain around 5%, while GNPA is estimated to improve from 1.77% in Q3FY21 to 1.15% by FY23E. The bank is currently trading at 1.9x / 1.7x FY22E/FY23E ABV. RoAs could rise to 1.0/1.1% by FY22E/23E led by improving PPOp and decline in credit costs.

We feel that investors can Buy CSB Bank at LTP and add more on dips to Rs. 212 (1.45x FY23E ABV) for the base case target of Rs.257 (1.75x FY23E ABV) and bull case target of Rs.278 (1.9x FY23E ABV) over next 2 quarters.

Financial Summary

Particulars (RsCr)	Q3FY21	Q3FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
NII	251.2	155.2	61.8	229.3	9.6	440.0	592.3	908.0	1103.8	1263.3
PPP	182.4	70.0	160.5	172.8	5.5	13.4	280.6	621.0	715.6	766.0
PAT	53.1	28.1	88.5	68.9	-23.0	-197.7	12.7	212.9	258.5	268.6
EPS (Rs)						-23.0	0.7	12.3	14.9	15.5
P/E (x)						NA	338.1	19.2	15.9	15.3
P/ABV (x)						2.0	2.6	2.1	1.9	1.7
RoAA (%)						-1.2	0.1	1.0	1.1	1.0

(Source: Company, HDFC sec)

Recent Developments

Q3FY21 highlights:

NII grew by 53% YoY and 10% QoQ. NIM improved to 5.17% in Q3FY21 from 4.5% last quarter. Non-Interest Income increases by 114%/20% YoY/ QoQ supported by improved treasury gains & PSLC commission. For Q3, PAT has been Rs 53 cr as against Rs 69 cr in Q2.

On the Asset Quality and Provisioning, Gross NPA has reduced from 3.04% to 1.77% QoQ while Net NPA reduced from 1.30% to 0.68%. Quantum of Net NPA is now only Rs 90 cr and as a percentage to Net worth it is only 5%. PCR increases to 91.03% from 84.24% in Q2FY21. Bank continues to provide accelerated provisions in Q3FY21. Collection vs Demand for the month of December 2020 stood at 95%. Cost Income Ratio for 9MFY21 period has improved from 70% to 49%. But due to higher opex, C-I Ratio for Q3 FY21 has increased to 50% from 47%.

Deposits have grown by 16% YoY and 2% QoQ. CASA deposits grew by 24% YoY and 5% QoQ. Term deposit growth during the quarter was muted as the bank was having surplus liquidity and as a conscious decision term deposit growth was not given attention. From Q4 onwards the company will be focusing on term deposit growth as well, since liquidity is now no longer in excess. CASA ratio has improved from 28.6% as on 31st Dec, 2019 to 30.4% as on 31st Dec, 2020. Advances have grown by 22% YoY and 5% QoQ. Gold loans continued to be key driver of loan growth posting YoY growth of 60% and QoQ 14%. Average LTV for gold loans stood at 75%. For the month of December 2020, the average LTV of loans disbursed stood at 82%. Tonnage wise gold jewellery pledged increased from 15.2 tons to 16.3 tons QoQ.

Improved Asset Quality

CSB in past have been plagued by higher stress largely from Corporate & SME segment. GNPA ratio was as high as 7.9% in FY18. Slippages averaged at 1.9% for FY19-20 (2.5% for 9MFY21) against 4.4% of slippages over FY14-18. We expect slippages to be sub 1% in FY22-23E. With recent capital infusion by promoter, bank has been able to write-off bad loans which led to significant improvement in asset quality. As of Q3FY21 GNPA & NNPA ratio stands at 1.77% and 0.68% respectively. Provision Coverage Ratio stood at 91.0%. Also 91% of Corporate advances are externally rated of which 55% are having A & above rating followed by BBB which comprises of 21% while <BBB and Others stood at 13% and 8% respectively.

Adequately capitalized for future growth

CSB's capital position has been significantly strengthened post capital infusion from FIHM and funds raising through IPO. The bank has received ~Rs 1200cr through issue of warrants to FIHM in FY19 and Rs 208cr through an IPO in Nov-2019 shoring up its CAR to 23%. Capital Adequacy Ratio improved from 19.69% as on 30th Sep, 20 to 21.02% as on 31st Dec, 2020. Liquidity Coverage Ratio at 200% which is well above the RBI requirement. The bank now has a strong capital base for growth acceleration, which it previously lacked.

Long term Triggers

Trusted brand across South India with strong branch network

CSB has operations in 16 states and 4 union territories with a branch network of 454 branches and ~16 lakh customers. Additionally the bank has developed alternate channels to enhance customer's online banking and digital payment solutions experience. CSB has a strong presence in South India with ~76% branches in Kerala and Tamil Nadu combined. Additionally, with a century of history, the bank believes it has developed a well-recognized and trusted brand in South India, particularly in Kerala and Tamil Nadu, where it has built strong relationships with many of its customers, which has been one of the key growth drivers of the bank.

The Bank offers a wide range of products and services to its customer i.e. SME, retail, and NRI customers. It delivers products and services through multiple channels, including branches, ATMs, debit cards, internet banking, mobile banking, point of sale services, and UPI.

Retail, SME to remain key growth drivers

In recent years, its growth was constrained by low capital adequacy and higher operating costs, which adversely impacted its financial performance. However, in last three Fiscals from Fiscal 2017 to Fiscal 2020, CSB Bank has improved its growth by focusing on better yield

loan products with low risk and therefore, the surplus funds parked in investments were redeployed to advances with particular focus on gold loans and corporate advances to entities with high credit ratings which have low risk weights to minimize capital consumption. As on Q3FY21, 83% of SME advances are rated as Low/Medium risk categories.

CSB aims to fuel its future lending growth by leveraging its expertise in retail, gold and SME. The bank intends to grow its retail portfolio with focus on gold loans, two-wheeler loans, loans against property and personal loan. The contribution from gold loans has been on the rise with the proportion of the same at 40% at the end of Q3FY21 and the management intends to maintain it at this level in the coming years. RBI has given freedom to the bank to open any number of branches and the management intends to open ~100 branches during current year mainly in gold loan focus areas. The plan is to have about 1000 branches within 4 years. CSB has an average ticket size of ~Rs 60,000 in gold loans and the recent increase in gold prices would allow the bank to lend more against the same security. Further, the bank plans to foray into using multiple channel such as business correspondence, direct selling agents and increasing branch presence to scale up its gold loan business.

Apart from retail loans, CSB focuses on meeting funding and banking requirements of SME customers. SME segment constituted ~15.2% of advances at the end of Q3FY21. SME business offers comparatively higher yields, cross-selling and associated business opportunities, and higher degree of secured and collateralized loans. Lending to SMEs also helps the bank to meet its priority sector lending target. As of FY20, the bank has a presence in 166 out of the 388 SME clusters identified by United Nations Industrial Development Organization (UNIDO) and it intends to expand to the remaining clusters with a focus on states of states of Tamil Nadu, Andhra Pradesh, Telangana, and Gujarat. Corporate segment contributes ~22.8% of advances at the end of Q3FY21. 91% of Corporate advances are externally rated of which 55% are having A & above rating.

Gold loan market poised to witness strong growth

India's gold loan market is expected to reach Rs 461,700cr by 2022 growing at a five-year CAGR (FY18 to FY22) of 13.4%, according to a report by KPMG. Organized gold loan penetration remains significantly low which provides ample opportunity for organized financiers' loan book growth. Overall gold loan stock with the organized sector forms a minuscule part of the total gold stock in the economy. However, this has been increasing at a steady overall pace. The organized gold loan market comprising banks (public, private, small finance and co-operative), non-banking finance company (NBFCs) and nidhi companies contribute to nearly 35 % of the Indian gold loan market.

Moreover, Prices of gold have rallied in the recent past and companies can lend more amount to their customers. CSB is having one of the highest proportion of gold loans to its total advances (40% of advances) in the banking industry and this untapped potential allows it to enhance this proportion even further on a growing balance sheet.

Granular & sturdy deposit franchise

The bank was dependent on term deposits to fund its growth in the past leading to higher interest expenses. With a view to reduce the cost of fund, the bank has started focusing on CASA deposits. Over the last four years CASA deposits of the bank have grown at a CAGR of 12.3% as compared to total deposit growth of just 2.3% leading to CASA ratio improving from 20% in FY16 to 29.2% in FY20. Consequently the calculated cost of funds has declined from 8% in FY16 to 5.8% in FY20. We expect the CASA ratio would further improve to over 30% by FY22 resulting in further moderation in cost of funds. As of Q3FY21 the CASA stood at 30.4%.

Experienced management with strong independent board

CSB's key managerial personnel, member of board & other senior employees have strong reputation within the industry, extensive industry relationships and wide-ranging experience in the banking and finance industry, which is poised to help the bank grow and evolve. Further, the members of the board have significant banking and finance experience, including in RBI, Nabard, Sidbi, KPMG, etc. The part-time chairman of CSB, Madhavan Karunakaran Menon, has over 30 years of experience in the financial sector. Mr CV Rajendran was appointed as CEO in Dec-16. The new management has successfully reduced the influence of unions, which had been a perennial issue in the bank.

What could go wrong?

Geographical concentration

The branches of the bank are concentrated in South India with Kerala accounting for 61% and Tamil Nadu for 15% at the end of Q3FY21. In business terms Kerala accounted for ~2/3rd of the deposits and ~1/3rd of the advances. Further, concentration in southern India, and specifically in Kerala, exposes it to many adverse economic, natural and political circumstances in the region compared to other public and private sector banks that have a more diversified national presence. 10% of branches are located in Maharashtra.

Increase in NPA may impact earnings

Recent COVID-19 issue is likely to have multiple order and far reaching impacts on the banking sector. Credit growth is already heading southwards and given the extensive nature of the lockdown, asset quality issues are likely to spread many sectors. On-going stress in Corporate and SME segment might accelerate and in fact retail loan segment might emerge as new source of stress. Lower than expected loan growth and greater than expected deterioration in asset quality remains key risk to our thesis. Sustainability of improvement in collection efficiency will be key monitorable.

Volatility in gold prices may impact financials

CSB's significant loan portfolio (40% of advances) consists of advances that are secured by gold ornaments. A sudden decline in the market price of gold may adversely affect CSB's financial condition, cash flows and earnings. Further, it may be unable to realise the full value of its pledged gold, which exposes the bank to a potential loss.

Execution Risk

The biggest risk for the stock is future execution of the management strategy. Failure to abide by it could impact financial performance which in turn could erode value for shareholders.

Deposit Mobilization

The events at YES and various other Co-operative Banks have impacted depositor sentiment, causing them to become more risk-averse. This will lead to deposit polarization towards large private banks and PSBs and we believe mid-tier banks could face challenges in deposit mobilization.

Company Profile:

CSB Bank is one of the oldest private sector banks in India & completed a century of existence this year, and a strong base in Kerala along with significant presence in Tamil Nadu, Karnataka, and Maharashtra. The bank is promoted by FIH Mauritius Investments Ltd (FIHM) which is a wholly-owned subsidiary of Fairfax India Holdings Corporation. The Bank offers a wide range of products and services to its customer base of 16 lakh, with particular focus on SME, retail, and NRI customers. It delivers products and services through multiple channels, including 454 branches (excluding three service branches and three asset recovery branches) and 319 ATMs spread across the country and various alternate channels such as micro ATMs, debit cards, internet banking, mobile banking, point of sale services, and UPI.

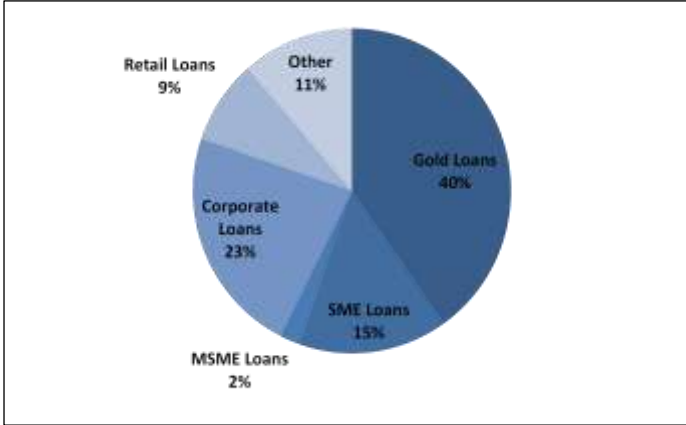
In October 2018, the bank partnered with the Toronto-based Fairfax group, which infused around Rs.1208 crore for 51% stake. Fairfax held around 49.73% as on December 31, 2020, and will have to reduce its stake to 15% over 15 years as per the existing regulatory requirement.

CSB Bank also distributes life insurance products of Edelweiss Tokio Life Insurance Company Limited, HDFC Life Insurance Company, and ICICI Prudential Life Insurance Company Limited, and general insurance products of ICICI Lombard General Insurance Company Limited and Reliance General Insurance Company Limited under contractual arrangements entered into with them, which increases its product portfolio and helps to generate fee income.

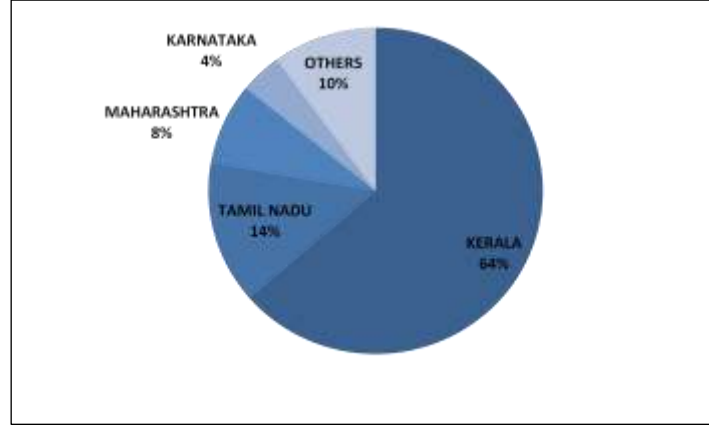
Peer comparison

	CMP	Mcap (Rs. Cr)	Q3FY21				FY23		
			NIM	GNPA	CAR	CASA	P/E	P/ABV	RoAA
CSB	237	4,106	5.2	1.8	21.0	30.4	14.1	1.5	1.0
CUB	180	13,306	4.1	2.9	17.4	27.5	13.7	2.0	1.5
Federal Bank	90.7	17,585	3.2	2.7	14.3	34.5	7.8	1.0	1.0
DCB	115.6	3,590	3.8	2.0	18.3	29.6	7.0	0.9	1.1
KVB	60.25	4,840	3.3	7.9	18.5	35.0	8.1	0.9	0.7

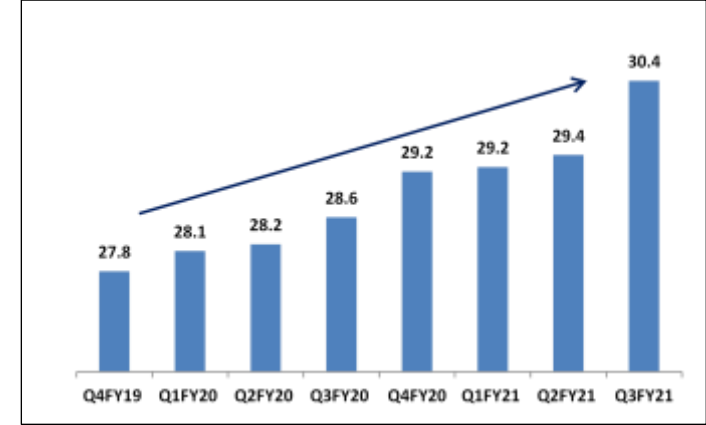
AUM Mix (%)



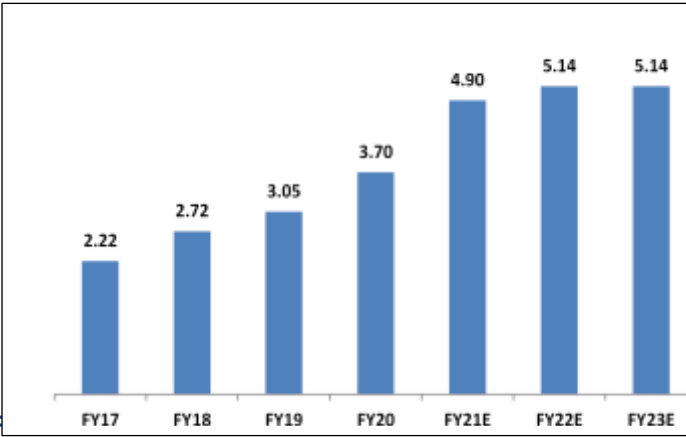
Branch Network



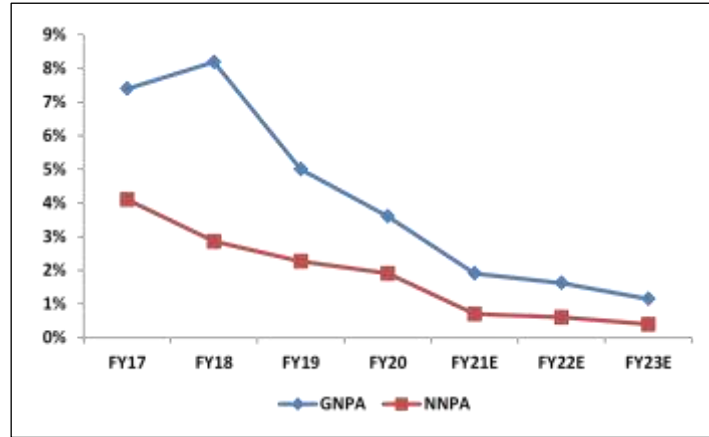
Rising CASA%



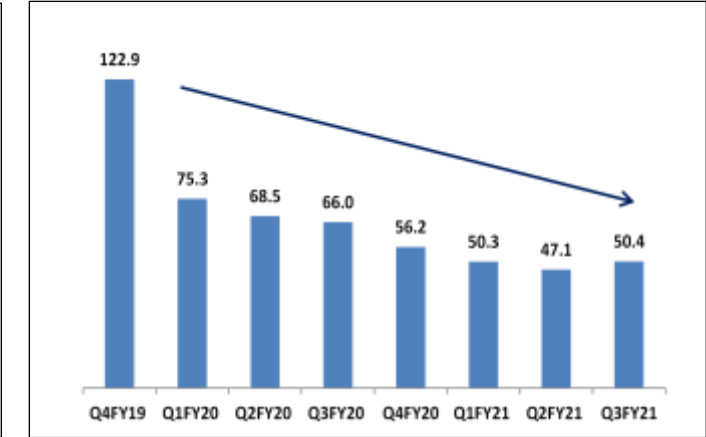
NIM Trend



NPA Trend



Cost to Income Declining Trend



(Source: Company, HDFC sec)

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Interest Income	1348	1510	1871	2200	2542
Interest Expenses	908	918	963	1097	1279
Net Interest Income	440	592	908	1104	1263
Non interest income	136	222	387	440	481
Operating Income	576	814	1295	1544	1744
Operating Expenses	563	533	674	828	978
PPP	13	281	621	716	766
Prov & Cont	314	147	337	371	408
Profit Before Tax	-300	134	284	345	358
Tax	-103	121	71	86	90
PAT	-198	13	213	259	269

Balance Sheet

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	86	174	174	174	174
Reserves & Surplus	1346	1787	2000	2259	2527
Shareholder funds	1432	1961	2174	2432	2701
Deposits	15124	15791	18150	20962	23897
Borrowings	0	794	1114	1418	1673
Other Liab & Prov.	368	319	497	547	602
SOURCES OF FUNDS	16924	18864	21935	25360	28873
Cash & Bank Balance	974	939	1065	1523	1356
Investment	4028	5360	5949	6544	7133
Advances	10615	11366	13583	15756	18592
Fixed Assets	218	228	251	276	304
Other Assets	1090	970	1087	1260	1487
TOTAL ASSETS	16924	18864	21935	25360	28872

(Source: Company, HDFC sec Research)

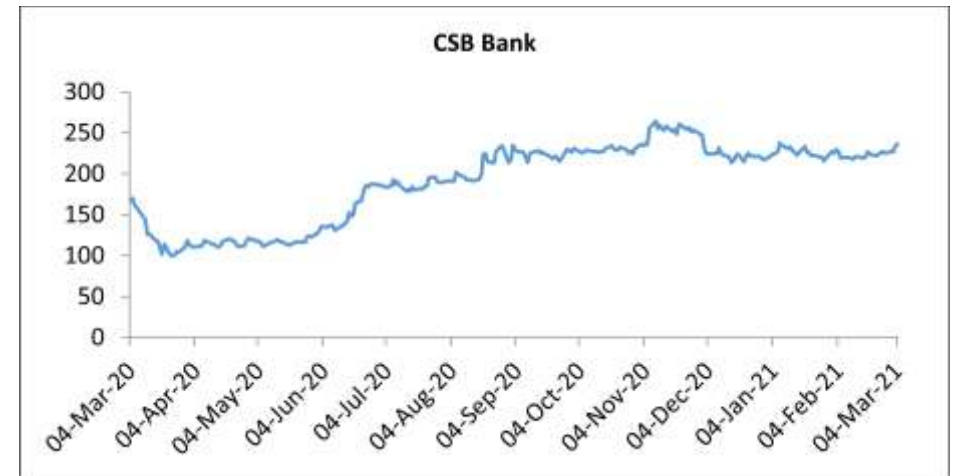
Key Ratios:

	FY19	FY20	FY21E	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	13.50%	13.70%	15.00%	15.00%	14.80%
Calc. Cost of borr	6.10%	5.80%	5.00%	4.90%	5.00%
NIM	3.00%	3.70%	4.90%	5.10%	5.10%
RoAE	-17.00%	0.80%	10.30%	11.20%	10.50%
RoAA	-1.20%	0.10%	1.00%	1.10%	1.00%
Asset Quality Ratios					
GNPA	5.00%	3.60%	1.90%	1.60%	1.10%
NNPA	2.30%	1.90%	0.70%	0.60%	0.40%
PCR	54.60%	47.00%	63.10%	62.60%	65.50%
Growth Ratios					
Advances	13.70%	7.10%	19.50%	16.00%	18.00%
NII	14.30%	34.60%	53.30%	21.60%	14.40%
PAT	LL	LP	1572.50%	21.40%	3.90%

(Source: Company, HDFC sec Research)

Key Ratios:

	FY19	FY20	FY21E	FY22E	FY23E
Valuation Ratios					
EPS	-23	0.7	12.3	14.9	15.5
P/E	NA	338.1	19.2	15.9	15.3
Adj. BVPS	120.2	91.4	110.7	125.6	142.3
P/ABV	2	2.6	2.1	1.9	1.7
Dividend per share	0	0	0	0	0
Other Ratios					
Cost-Income	97.7	65.5	52	53.7	56.1
CASA	28%	29%	30%	31%	31%
CAR	16.7	22.5	21	20.1	19.8
Tier 1	16	21.8	20.5	19.6	19.4



Disclosure:

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