RETAILRESEARCH

Stock Update

CSB Bank Ltd.

September 24, 2021

HDFC securities
Click. Invest. Grow.
20 YEARS

CSB Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Banks	Rs.303	Buy at LTP of Rs.303 & add more on dips of Rs.267	Rs.333	Rs.355	2 quarters

HDFC Scrip Code	CSBBAN
BSE Code	542867
NSE Code	CSBBANK
Bloomberg	CSBBANK IN
CMP Sep 23, 2021	303
Equity Capital (Rs cr)	174
Face Value (Rs)	10
Equity Share O/S (cr)	17.4
Market Cap (Rs cr)	5,257
ABook Value (Rs)	116
Avg. 52 Wk Volumes	508442
52 Week High	372.95
52 Week Low	197.05

Share holding Pattern % (Jun, 2021)	
Promoters	49.7
Institutions	16.4
Non Institutions	33.9
Total	100.0

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Nisha Sankhala
Nishaben.shankhala@hdfcsec.com

Our Take:

CSB Bank is a century old private sector bank in India having a strong base in Southern India. After being taken over by new promoters (Toronto-based Fairfax group), the real transformation had started. Changes like creating new brand image, funding the capital for growth, strengthening top management by bringing in new experienced people, product based lending approach etc. were done. And now after achieving critical transformation, the bank has started focusing on growth. Aggressive branch expansion, digitization & technology on boarding, improving CASA ratio to lower cost of funds, strengthening retail segment by launching new product suite are a few key focused areas. The bank is well capitalized to fund growth without raising capital for next 12-18 months. However, we will remain watchful on collection efficiencies front and asset quality trend going ahead. Over dependence on gold loans and South India being a key market place brings concentration risk. The possibility of third wave and fresh lock downs could hurt the business.

We had issued Initiating Report on CSB Bank on 5th March, 2021 and recommended Buy at LTP of Rs.237 and add further at Rs.212, for base case target of Rs.257 and bull case target of Rs.278 over the next two quarters. The bull case target of Rs.278 was achieved on 8th March, 2021 yielding return of 17.4%.

Link for the Initiating Report:
https://www.hdfcsec.com/hsl.research.pdf/CSB%20Bank%20Ltd.-%20Initiating%20Coverage-%2005032021.pdf

Valuation & Recommendation:

We have envisaged 18.5% CAGR for NII and 29% CAGR for Adjusted Net Profit over FY21-23E, while the loan book is estimated to grow at ~19.5% CAGR over same time frame. The bank has strong provision coverage ratio. We feel that operating cost will remain elevated due to aggressive branch expansion. Management expects that worst in terms of asset quality is over and expects strong recovery especially in gold loans as unlocking progresses. The target is to reach to GNPA below 2% and NNPA below 1% by FY24 with PCR ~80%, while cost to income ratio is targeted below 50% and CASA ratio above 40%.

We believe that investors can buy CSB Bank at LTP of Rs.303 (2.05xFY23E ABV) and add more at Rs.267 (1.8xFY23E ABV) for the base case fair value of Rs.333 (2.25xFY23E ABV and for the bull case fair value of Rs.355 (2.4xFY22E ABV) over the next two quarters.

Financial Summary

Particulars (Rs cr)	Q1 FY22	Q1 FY21	YoY (%)	Q4 FY21	QoQ (%)	FY20	FY21	FY22E	FY23E
NII	267.8	185.3	44.5	275.7	-2.9	592.3	941.4	1087.5	1322.0
PPP	179.8	129.0	39.4	129.0	39.4	280.6	613.2	637.3	781.6
PAT	61.0	53.6	13.8	42.9	42.2	12.7	218.4	235.0	362.7
EPS (Rs)						0.7	12.6	13.5	20.9
P/E (x)						412.7	24.1	22.4	14.5
P/ABV (x)						3.0	2.6	2.4	2.0
RoAA (%)						0.1	1.0	0.9	1.2

(Source: Company, HDFC sec)

Recent Developments

Q1FY22 Result Update

Net Interest Income (NII) earned for the quarter stood at Rs 267.75 Cr with a YoY increase of 45%. It was down 3% QoQ, mainly because of interest reversal on gold loan NPAs. NIM declined by 28 bps QoQ. Operating Profit of the bank was Rs 179.78 Cr - a growth of 39% YoY. Profit After Tax was at Rs 61 Cr in Q1FY22 as against Rs 53.56 Cr in Q1FY21 and Rs 42.89 Cr for the sequential quarter. Net profit increased by 14% YoY and 42% on QoQ basis. Operating expenses were higher due to rise in both number of employees and branches. Advances grew by 2588.55 Crs to 13817.17 Cr YoY registering a growth of 23%, while deposit grew by 14% YoY. CASA Deposits also grew by 29% YoY. CASA ratio has improved from 29.23% last year same quarter to 33.09% in Q1FY22 . Going forward, Management expects C/I to remain at below 50% levels (47.7% in Q1).

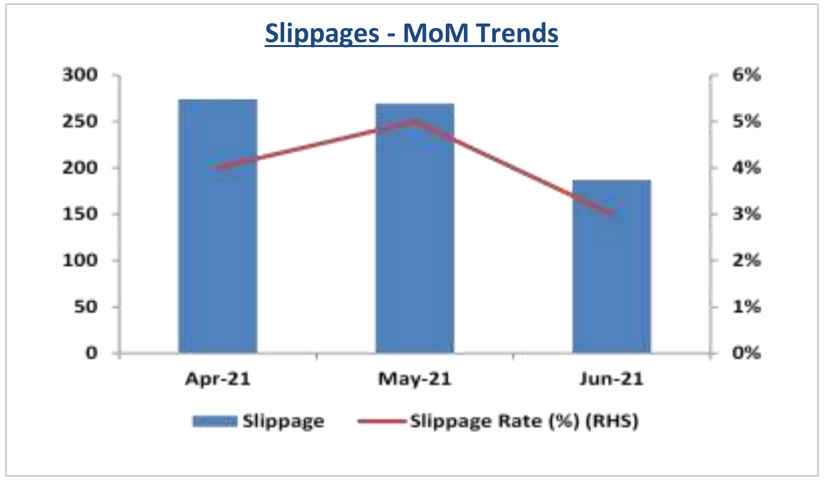
Reverting to 75% LTV regime impact

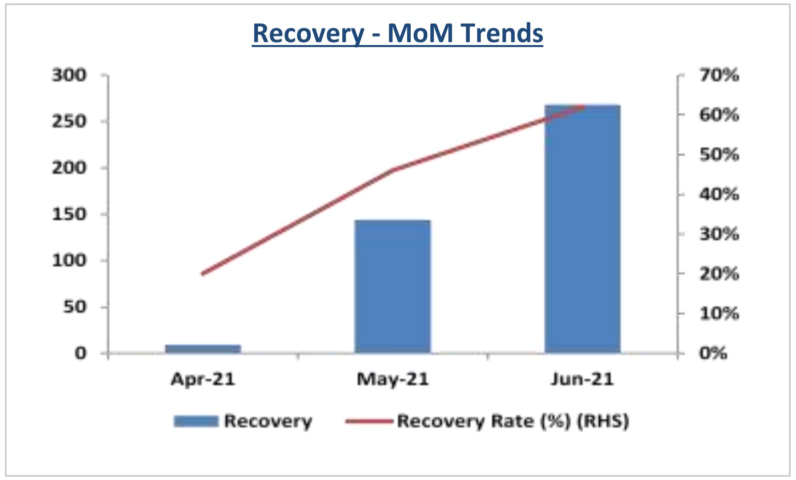
RBI in August, 2020, had decided to increase the permissible loan to value ratio (LTV) for loans against pledge of gold ornaments and jewellery for non-agricultural purposes from 75% to 90%. This enhanced LTV ratio was applicable up to March 31, 2021 to enable the borrowers to tide over their temporary liquidity mismatches on account of COVID-19. This had impacted the loan growth of the bank during the quarter. Advances fall by 4% QoQ mainly because of fall in gold loan portfolio by 8%. The average LTV for gold loans, which was at 83% in March, has been brought down to 75%. This has not only impacted the growth but also the asset quality because the customers had to pay difference in LTV along with the interest.

Asset Quality

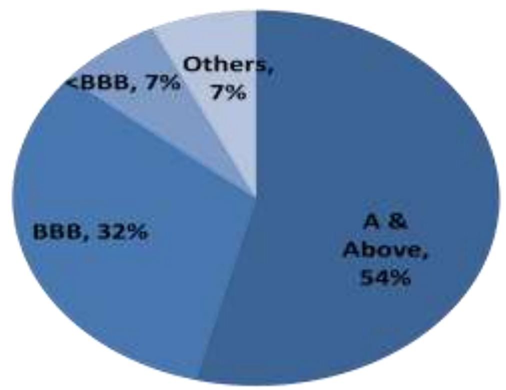
During the quarter the asset quality deteriorated significantly due to COVID second wave challenges coupled with the LTV management of gold loans. Gross NPA for the quarter stood at 4.88% as compared to 3.51% YoY and 2.68% QoQ, while Net NPA for the quarter stood at 3.21% as compared to 1.74% YoY and 1.17% QoQ. Similarly, PCR decreased from 85% to 70% QoQ. Considering the accelerated standard asset provision in excess of the RBI requirements, amounting to Rs.104 Cr, PCR works out to 77%. The bank has an accelerated provisioning policy for ensuring high PCR through the cycle. Total slippages were at Rs.435 Cr of which Rs.337 Cr were from gold loans. Restructured loans were 0.48%. Collections efficiency in June was at 93% excluding gold loans. Gold loan segment collection efficiency at was 20% in April, 46% in May and 62% in June. Management has informed that worst seems to be over on gold loan front and they will be able to recover the gold loan NPAs in the coming months which will help to improve the asset quality metrics and PCR. However, in the recent months the COVID cases in Kerala has risen and many parts were under lock down, this might have hurt the bank's business coming from those regions.

Below chart shows that downward trend in slippages has started with the easing of Covid related restrictions. Management informed that stable gold market trends and the centralization of recovery processes are supporting collections.





External Rating of Corporate Accounts



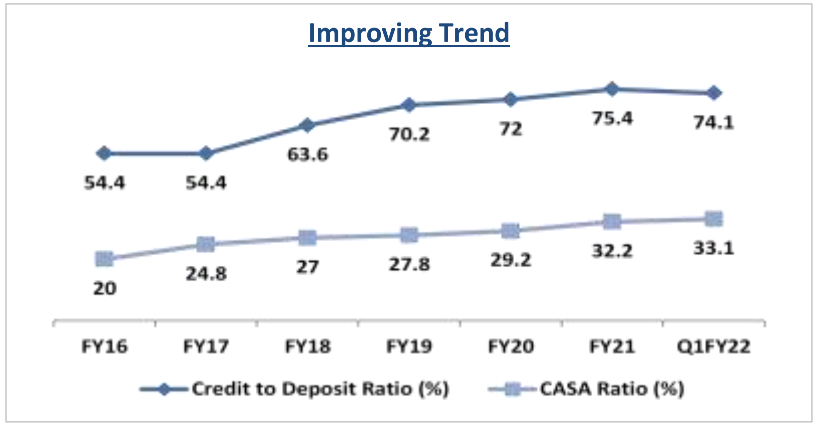
Sector Wise Exposure

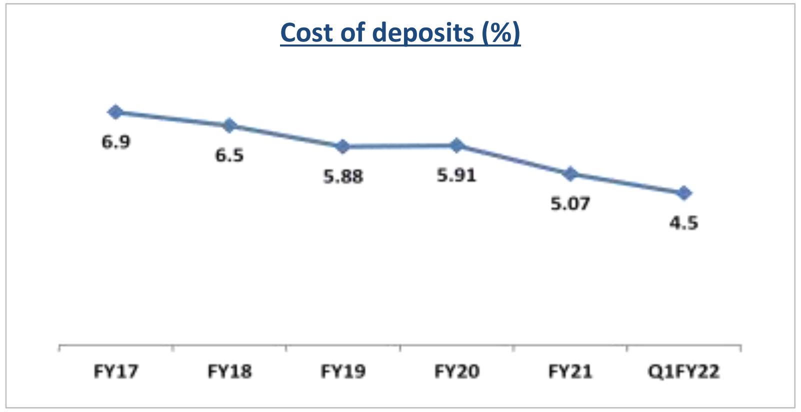
Healthy Capital Adequacy

As mentioned in the initiating report, the capital positioning of the bank has improved post capital infusion from FIHM. Follow up funds raising via IPO has helped further. CSB bank has strong liquidity profile and adequate capital buffer. As of Q1FY22, the capital adequacy ratio (CAR) stood at 21.6% and tier-1 at 20.2%, well above regulatory requirement. It has strong liquidity with LCR (liquidity coverage ratio) of 171% and comfortable leverage ratio of 8.37%. With Gold loan (comparatively lower risk weights) contributing majority of the loan book, the capitalization levels are enough to fund growth without raising any capital for next 12-18 months. With the Fairfax name association the bank now has reasonable ability to raise additional equity from the market.

Improving CASA profile

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 funds, the bank has started focusing on CASA deposits. This is clearly evident from the CASA ratio improvement (from 20% in FY16 to 32.2% in FY21) and consequently the cost of funds has also reduced significantly. During the quarter the CASA deposits also grew by 29% YoY, while the CASA ratio improved remarkably from 29.23% last year same quarter to 33.09% in Q1FY22. Due to CSB’s legacy of being a community-driven bank and having a presence in remittances (especially from NRIs in the Middle East), the bank’s non-resident external deposits constitute over 20% of its total deposits. The bank’s has aggressive branch expansion plan for next 2-3 years. With these branches maturing, the bank will have more granular deposit base and dependence on Kerala and Tamil Nadu will also reduce.





Achieved critical transformation now fully focus on growth

CSB bank (erstwhile Catholic Syrian Bank) has existence of over 100 years. But the transformation journey began with the new promoter taking over. RBI took an exception and permitted a 51% stake by Fairfax India Holdings in Jul-2018. After that significant changes were done to transform a sort of an old world bank into a full service new age private sector bank like changing the brand image, funding the capital for growth, strengthening top management by bringing in new experienced people, product based lending approach etc. There was a re-alignment of organizational set-up along with branch rationalization. The branches now are responsible only for deposits, cross selling, and customer servicing, and all loan products are driven by dedicated teams, with each business team operating as a profit centre. The new management has successfully reduced the influence of unions, which had been a perennial issue in the bank. Presence of Fairfax as a promoter enhances the bank's capability to attract talent and improve governance through the implementation of best practices.

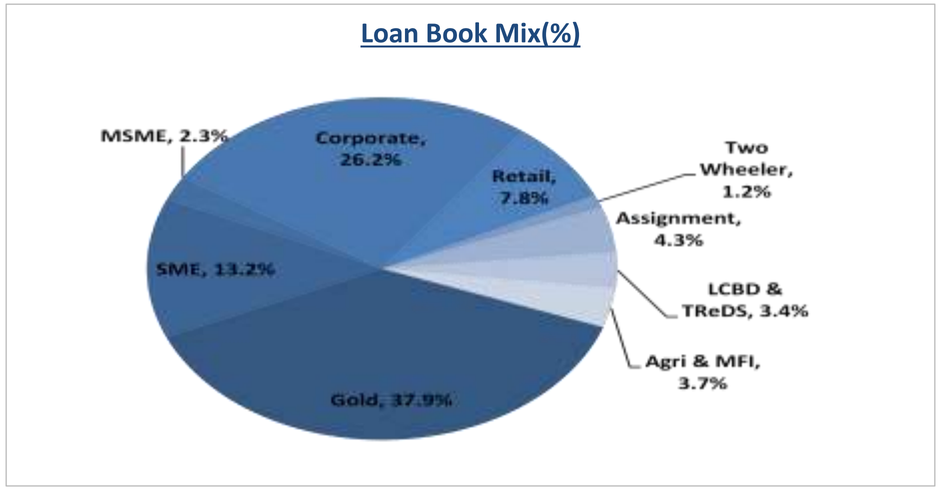
After whole host of new changes, the bank has now focused on growth which includes branch expansion, digitization & technology on boarding, improving CASA ratio to lower cost of funds and strengthening retail segment by launching new product suite.

Strengthening retail product suite:

Like last couple of years, the bank will continue focusing on better yield loan products. It aims to fuel its future lending growth by leveraging its expertise in retail, gold and SME. CSB is in the process of building the systems and processes for scaling up the retail loans. As per the management, currently for the time being it has explored the partnership model. Also, it is not looking to keep the home loans in its book and will sell it for commission. The bank intends to grow its retail portfolio with focus on gold loans, twowheeler loans, loan against property and personal loan. The contribution from gold loans is around 40% and the management intends to maintain it at this level in the coming years.

The Bank would be introducing wider range of products, to have larger share of customers' wallet to meet their needs. Such products would be governed by structured product programs specific to the business, which will detail out the criteria on customer selection and underwriting standards. Management has informed that they are planning to strengthen the product suite by offering housing loans, credit card, online broking, online mutual fund and health insurance.

Apart from retail loans, CSB bank will focus on meeting funding and banking requirements of SME customers. SME segment constituted ~15.6% (including MSME) of advances at the end of Q1FY22. SME yields stood at ~10.5-11.5% It also provides cross-selling and associated business opportunities with higher degree of secured and collateralized loans. Lending to SMEs also helps the bank to meet its priority sector lending target.



Digitization & technology:

Digitization & technology has been one of the key focus areas of the new management. In the past few years the bank has started investing in the new technologies and platforms for improving the processes and to deliver a new age banking experience to customers. Some of the new digital banking initiatives include video KYC facility, online platforms for Mutual funds and Insurance products etc. Account opening process has also been digitized with options for customer to apply as well as branch staff to facilitate the process. The bank also plans to explore partnerships in the co-lending and fintech space on various digital offerings, including cards.

Branch Expansion:

CSB Bank has regional concentration with almost 84% branches situated in Kerala, Tamil Nadu, Maharashtra and Karnataka. In terms of deposit profile these states contributes 91% as of Q1FY22. Among these four states, the bank is majorly dependent on Kerala and Tamil Nadu for total business. However, the management has stated the focus will be opening branches at newer geographies. The bank has been expanding branches at a good speed and going ahead also the strategy for growth will remain the same. Last year the bank has opened 101 branches (of which only nine were in Kerala and the remaining were predominantly in Tamil Nadu, Andhra Pradesh, Telangana, Maharashtra and the northern states of the country) and 11 new were added in last quarter (six unviable branches were merged) thus taking the total network to 517. For Q2FY22 the bank has guided to open 50 branches and for FY22 the target is to add 200 new branches outside Kerala and Tamil Nadu. Average cost for new branch is ~Rs 10 lakh per month in rural & semi-urban areas where there's a break even on the business volume of Rs 10-12 Cr while in the urban areas the cost of new branch is ~Rs 20 lakhs per month which breaks even on the business volume of ~Rs 25 Cr.

High geographical concentration:

	Distribution (%)				
	Branch	Deposits	Advances	CASA	Gold loans
Kerala	51	63	31	63	38
Tamil Nadu	16	15	28	16	33
Maharashtra	10	9	21	9	6
Karnataka	7	5	7	4	8
Others	16	8	13	8	13

Further the management has also informed that they are in the process of setting up NRI Branches across key metros and markets with high concentration of NRIs. These branches will give differentiated services for NRIs by leveraging technology. The bank will also work on setting up a world class remittances platform along with providing PIS offering to the clients. They would also be leveraging tie ups with domestic and international institutions for acquiring new NR relationships.

Risks & Concerns

- The possibility of a third Covid wave and fresh lock downs could hurt the business on multiple fronts i.e. liquidity, asset quality, loan growth, collections etc.

- During Q2FY21, the COVID cases in Kerala rose significantly and many areas were under lock downs. This could impact the earnings as almost 51% of the CSB bank's branches are located in Kerala.

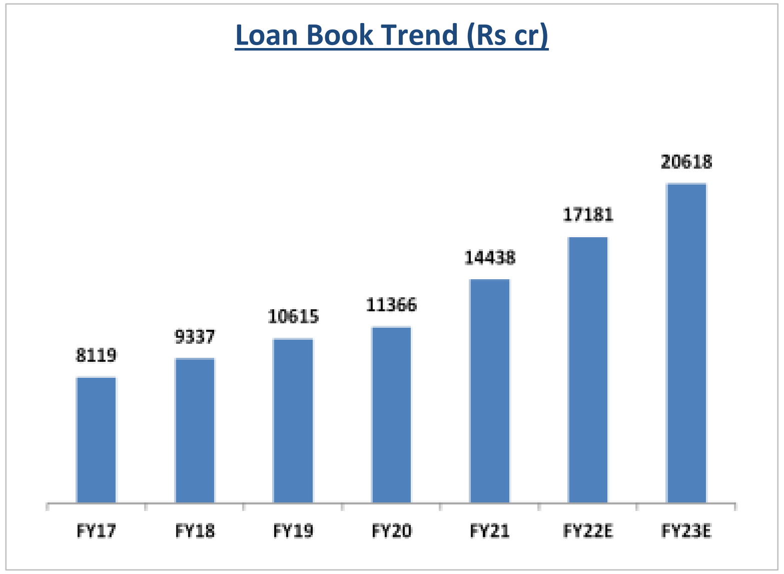
- The bank has high concentration both in terms of regional presence (as described above) and asset class. Almost 38% of the loans have been given against gold, high volatility in the gold prices could affect the bank's financial condition, cash flows and earnings.

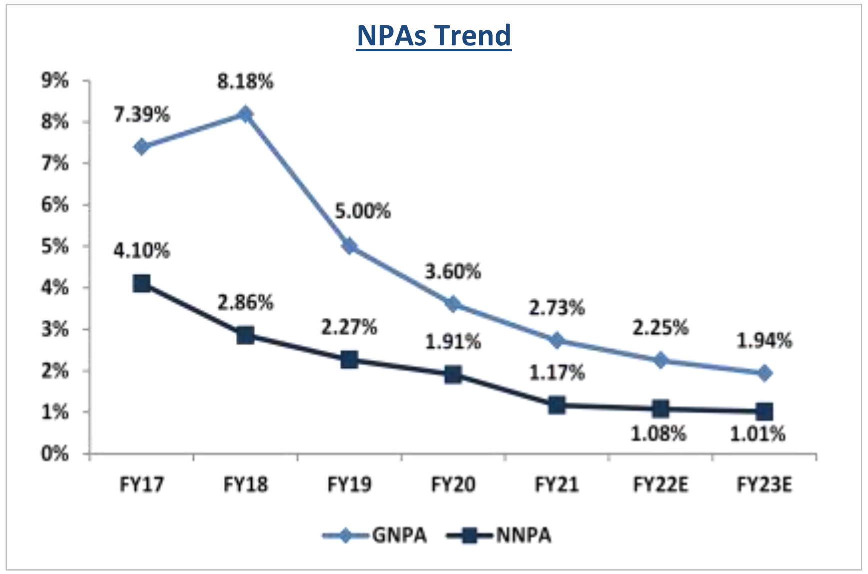
- The biggest risk for the stock is future execution of the management strategy. Failure to abide by it could impact financial performance which in turn could erode value for shareholders.

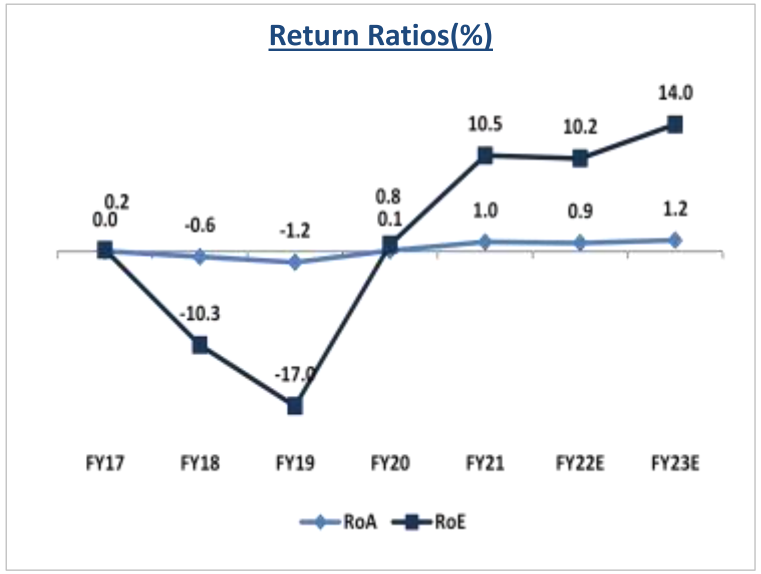
- Fairfax owns 49.7% stake now. This holding has to be brought down as mandated by RBI over a period of 15 years from the completion of their investment in the Bank in 2019.

Company Background:

CSB Bank is one of the oldest private sector banks in India with an existence of over 100 years. While the bank has a long operating history as a traditional bank, it is currently focusing on implementing strategic changes in business model to function efficiently like a full service new age private sector bank. It has a strong base in Kerala along with significant presence in Tamil Nadu, Maharashtra, Karnataka and Andhra Pradesh. The bank offers a wide range of products and services to overall customer base of 1.7 million, with particular focus on SME, Retail, and NRI customers. It delivers the products and services through multiple channels, including 517 branches (excluding three service branches and three asset recovery branches) and 335 ATMs/CRMs spread across the country and various alternate channels such as micro ATMs, debit cards, internet banking, mobile banking, point of sale services, and UPI.







Financials

Income Statement

(Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	1348	1510	1872	2292	2703
Interest Expenses	908	918	931	1205	1381
Net Interest Income	**440**	**592**	**941**	**1088**	**1322**
Non-interest income	136	222	401	379	416
Operating Income	**576**	**814**	**1342**	**1467**	**1738**
Operating Expenses	563	533	729	830	956
PPP	13	281	613	637	782
Prov & Cont	314	147	321	324	298
Profit Before Tax	-300	134	293	313	484
Tax	-103	121	74	78	121
PAT	**-198**	**13**	**218**	**235**	**363**

Balance Sheet

(Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Share Capital	86	174	174	174	174
Reserves & Surplus	1346	1787	2007	2242	2604
Shareholder funds	**1432**	**1961**	**2180**	**2415**	**2778**
Deposits	15124	15791	19140	23129	26907
Borrowings	0	794	1426	1460	1856
Other Liab & Prov.	368	328	599	659	725
SOURCES OF FUNDS	**16924**	**18874**	**23345**	**27664**	**32266**
Cash & Bank Balance	974	939	1714	2392	2668
Investment	4028	5360	6126	6677	7212
Advances	10615	11366	14438	17181	20618
Fixed Assets	218	253	269	296	326
Other Assets	1090	955	798	1117	1443
TOTAL ASSETS	**16924**	**18874**	**23345**	**27664**	**32266**

Key Ratios

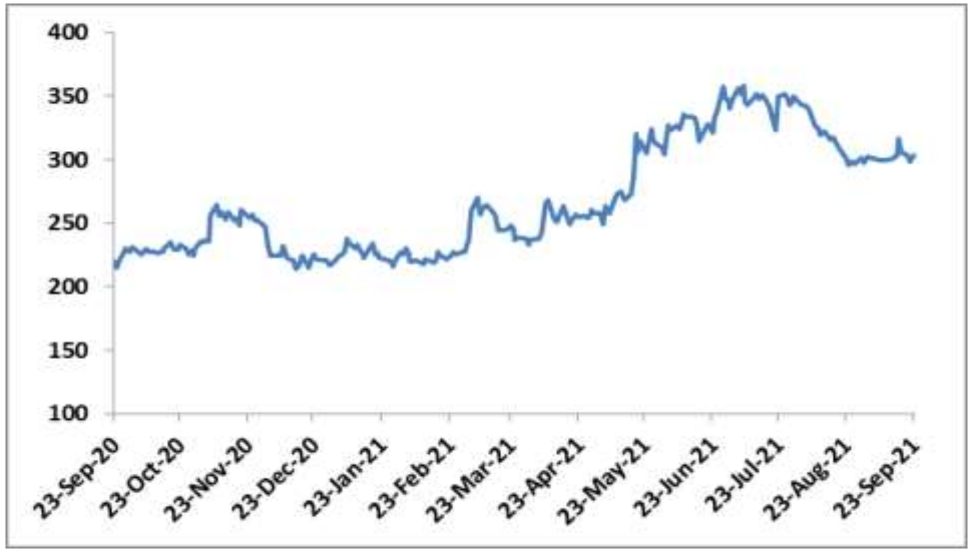
	FY19	FY20	FY21	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	13.50%	13.70%	14.50%	14.50%	14.30%
Calc. Cost of funds	6.10%	5.80%	5.00%	4.90%	4.80%
NIM	3.00%	3.70%	4.90%	4.60%	4.80%
RoAE	-17.00%	0.80%	10.50%	10.20%	14.00%
RoAA	-1.20%	0.10%	1.00%	0.90%	1.20%
Asset Quality Ratios					
GNPA	5.00%	3.60%	2.70%	2.20%	1.90%
NNPA	2.30%	1.90%	1.20%	1.10%	1.00%
PCR	54.60%	47.00%	57.10%	51.80%	47.60%
Growth Ratios					
Advances	13.70%	7.10%	27.00%	19.00%	20.00%
NII	14.30%	34.60%	58.90%	15.50%	21.60%
PAT	LL	LP	1615.30%	7.60%	54.30%

(Source: Company, HDFC sec)

Key Ratios

	FY19	FY20	FY21	FY22E	FY23E
Valuation Ratios					
EPS	-23	0.7	12.6	13.5	20.9
P/E	NA	412.7	24.1	22.4	14.5
Adj. BVPS	138.5	100.5	115.9	128.5	148
P/ABV	2.2	3	2.6	2.4	2
Dividend per share	0	0	0	0	0
Other Ratios					
Cost-Income	97.7	65.5	54.3	56.6	55
CASA	28%	29%	32%	34%	36%
CAR	16.7	22.5	21.4	19.2	19
Tier 1	16	21.8	20	18	18

One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No. ARN: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193