

Turnaround Story; Pace Will Pick Up



CSB Bank has done a remarkable job in turning around the balance sheet through difficult times. The bank is not only improving its core operating metrics but also focus on risk adjusted growth to drive returns. Post the new management took over, the clean-up of asset quality had begun with a write-off of weaker SME & corporate exposures and decline in GNPA from its peak of ~7.9% to ~2.7% in FY21.

Key takeaways from management interaction

- Gold loan is operation intensive business, with the cost of operation being ~5.5%, while Bank's average gold loan yield is ~ 11.5-12.5%.
- Management expects C/I to remain at below 50% levels (47.7% in Q1).
- Once the non-gold book starts growing, NIMs may come under pressure. Management believes NIM should stabilize ~ 4.5%.
- Bank is well capitalized and would not need capital infusion for the next 12-18 months.
- Given the second & third wave of covid, Bank is keeping cautious approach and is likely to grow at ~12-15% in FY22.
- Fairfax owns 49.7% stake now. The holding is subject to the dilution schedule as mandated by RBI and the same is spread over a period of 15 years from the completion of their investment in the Bank in 2019.

Aspirations for FY2024

- GNPA's below 2%, NNPA's below 1% and PCR~80%
- RoA 1.5% and RoE ~18%
- Cost to income ratio less than 50% and CASA ratio above 40%

Valuation & Outlook

We remain positive on the stock given its favorable loan mix, sustained margins, and comfortable liquidity position. Profitability of the bank should see improvement in the next few quarters driven by higher loan growth, stable margins, decline in credit costs, and lower cost to income ratio. Besides, strong liability franchise, adequate capitalization, and healthy provision buffer add to positivity. We expect the bank's RoA/RoE to be around 1.1%/11.8% in FY22 and improved to 1.3%/14.7% in FY23. At CMP the stock trades at 2.3x its FY22E ABV and 2.0x its FY23E ABV. We assign BUY rating with a Target Price of Rs 375/share, valuing the stock at a target multiple of 2.5x FY22E ABV. We believe the bank's current valuation and recent earnings provide limited downside risk.

Financial Summary

Y/E Mar (Rs Bn)	FY20	FY21E	FY22E	FY23E
NII	5.9	9.4	11.2	13.0
Net profit	0.1	2.2	2.7	3.9
Net worth	19.6	21.8	24.5	28.4
EPS (Rs)	0.7	12.6	15.8	22.4
P/E (x)	413	24	19	13
P/Adj BV (x)	3.0	2.6	2.3	2.0
RoA (%)	0.1	1.0	1.1	1.3
RoE (%)	0.8	10.5	11.8	14.7

Source: Dalal & Broacha Research, Company

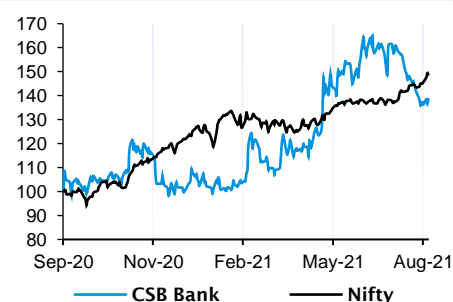
Rating	TP (Rs)	Up/Dn (%)
BUY	375	25

Market data

Current price	Rs	300
Market Cap (Rs.Bn)	(Rs Bn)	52
Market Cap (US\$ Mn)	(US\$ Mn)	708
Face Value	Rs	10
52 Weeks High/Low	Rs	373/197
Average Daily Volume	('000)	217
BSE Code		542867
Bloomberg		CSBBANK:IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Jun-21	Mar-21
Promoters	49.7	49.7
FII	5.5	5.3
DII	11.2	9.3
Others	33.6	35.7
Total	100	100

Source: BSE

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Takeaways from management interaction

Gold loan business

- Gold loan portfolio will remain 30-40% of the total portfolio in the near term. Once other segments start growing at a faster rate, the gold loan proposition will come down below 30%. However, it will remain a meaningful part of a retail book.
- Bank's growth strategy towards the gold loan business will continue to remain aggressive.
- Bank has an experienced team for handling the gold loan business as recruitments were made considering their experience in mainly gold loan NBFCs, etc.
- Many branches have exclusive gold loan people, who don't participate in any other activities. Therefore, the bank's turnaround time is much faster than PSU banks and it can be compared with gold loan NBFCs.
- Gold loan is operation intensive business, where the cost of operation is ~5.5%
- Average LTV for gold loans, which was at 83% in March, has been brought down to 77% in Q1FY22.
- Bank's average gold loan yields are 11.5-12.5%, which is much lower than most of the gold loan NBFCs
- The decline in gold loans was reportedly owing to subdued disbursements due to lockdowns announced by various states, a higher focus on recovery, and shorter tenure of gold loans, which led to higher repayments.

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SME Portfolio

- SME yields stood at ~10.5-11.5%
- SME portfolio could have NPAs up to 5% but the ultimate loss will be much lower due to better collateralization

MFI Portfolio

- MFI portfolio will start growing faster in the second half of FY22.
- Bank originates MFI loans through Business Correspondents (BCs), with the first default guarantee of up to 5%.
- MFI portfolio will remain in the bank's book.
- While BCs might disburse loans at 18-20%, Bank's yields on MFI portfolio ~10-12%.

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Other Business

- Bank is in the process of building the systems and processes for scaling up the retail loans. For the time being partnership model will be explored. Bank is not looking to keep the home loans in its book and will sell it for commission.
- Given the small customer base, Bank is not coming up with its own credit card. However, Bank is negotiating with one large card issuer for a co-branded credit card.

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Asset Quality

- Increase in GNPA is mainly because of higher gold loan slippages in Q1FY22. However, losses in gold loan NPA may not be significant, and recovery will be better in the coming quarters.
- Gold NPA recovery trend is gaining traction every month with April being at 20%, May at 46%, June at 62%, and the same is improving considerably post lifting the lockdown restrictions.
- Normally when auction notice is given, more than 90% of customers repay, while auctions are conducted for the remaining clients. In the current scenario when client's incomes are hit and there are no social functions, clients don't feel the urgency to reclaim their gold by repaying loans.
- During Q1, other than gold loan only Rs 98 cr slipped mainly from travel agents, hotels, transport operators, etc. The largest account there is worth Rs 12 cr, which has been given to the Volvo Bus operator.
- Bank is holding excess provision of ~Rs 300 cr more than minimum regulatory requirement.
- Bank has an accelerated provisioning policy which ensures that the bank maintains a high PCR through the cycle.
- As per the bank's internal provisioning policy for Sub Standard Assets, it provides 25% provision for Secured loans and 50% provision for Unsecured loans as against the minimum regulatory requirement of 15% and 25% respectively. Same for Doubtful Assets (Up to one year) it provides 50% provision for Secured loans and 100% provision for Unsecured loans as against the minimum regulatory requirement of 25% and 100% respectively.
- There is no stress in the corporate book and haven't seen single default in the last few months.

Operating Performance

- Management expects C/I to remain at below 50% levels (47.7% in Q1).
- Once the non-gold book starts growing, NIMs may come under pressure. Management believes NIM should stabilize ~ 4.5%.
- Bank is looking to add ~200 branches in the next one year and out of which 85 will be opened in the first phase. These new branches will be opened in areas with gold loans, Agri & MFI loans, MSME loans, and CASA potential in line with the strategic priorities of the bank.
- Specifically, the bank will be opening more branches in those areas where they saw good traction e.g. Tamil Nadu where most of the bank's branches break even in the first 10 to 12 months. Bank also saw good traction in Andhra Pradesh & Telangana, where they already opened about 40 branches in Q4FY21.
- Average cost for new branch is ~Rs 10 lakh in rural & semi-urban areas (which break even on the business volume of Rs 10-12 Cr), and ~Rs 20 lakhs for urban areas (which break even on the business volume of ~Rs 25 Cr).

Other Highlights

- Although Bank currently doesn't have any fintech tie-ups, it is progressing talks with few tech companies for the same.
- Bank is well-capitalized and would not need capital infusion for the next 12-18 months.

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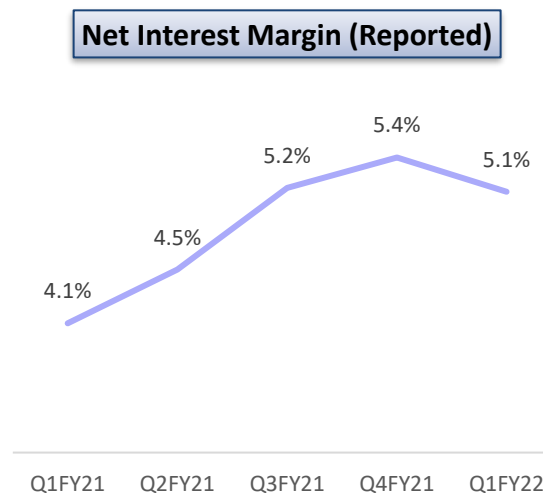
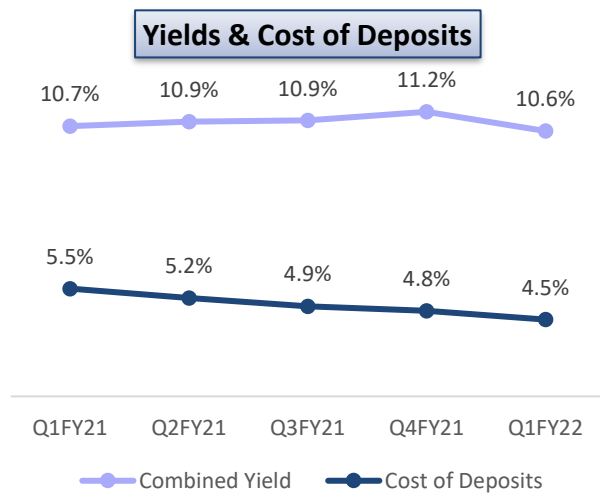
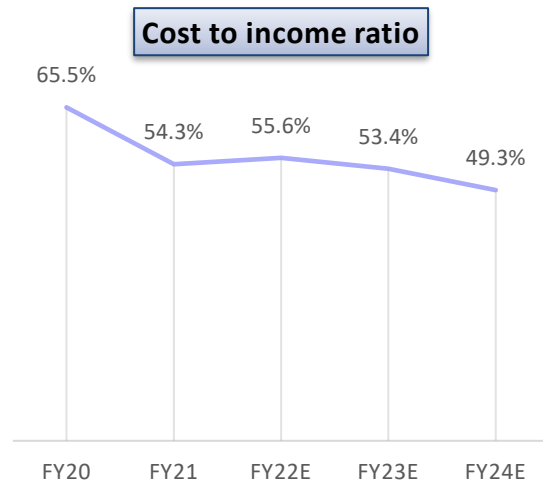
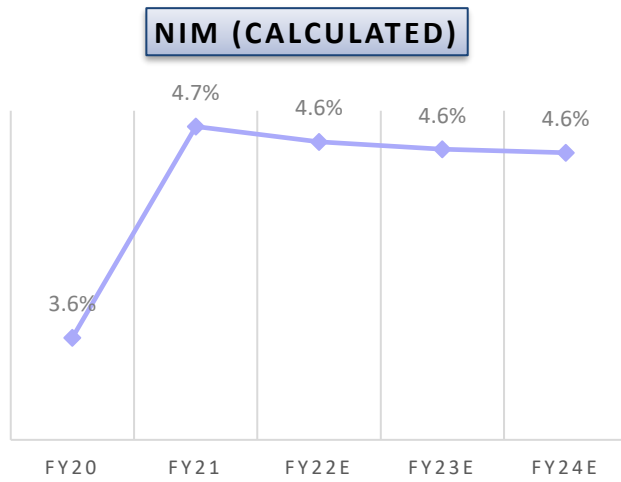
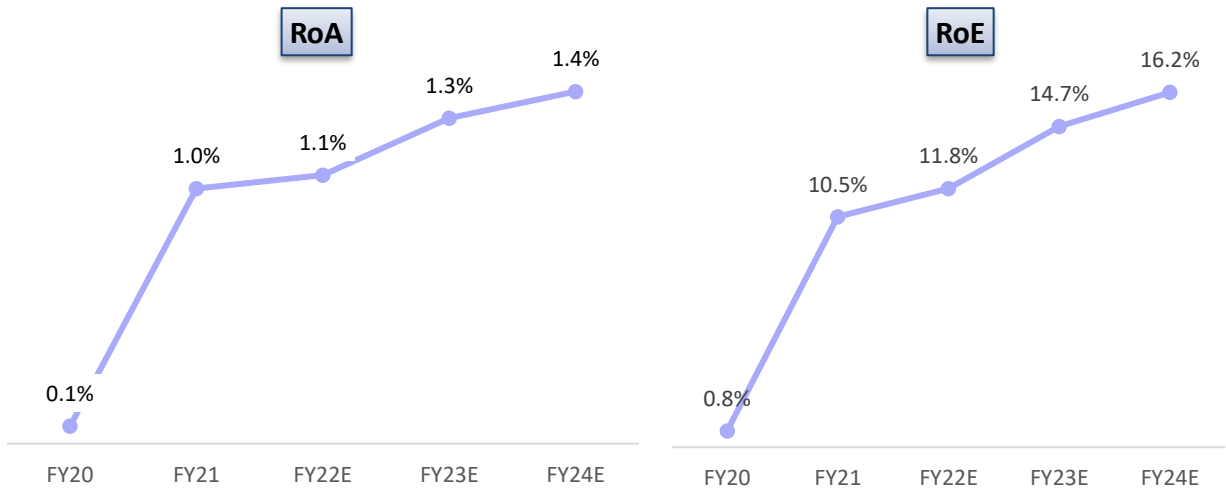
The bank will be opening more branches in those areas where they saw good traction e.g. Tamil Nadu where most of the bank's branches break even in the first 10 to 12 months

Bank is well-capitalized and would not need capital infusion for the next 12-18 months

Pictures speak louder than words

(If things go as planned, the bank's return ratios will improve meaningfully in the coming years, supported by higher loan growth, stable cost to income ratio, better margin and lower credit cost)

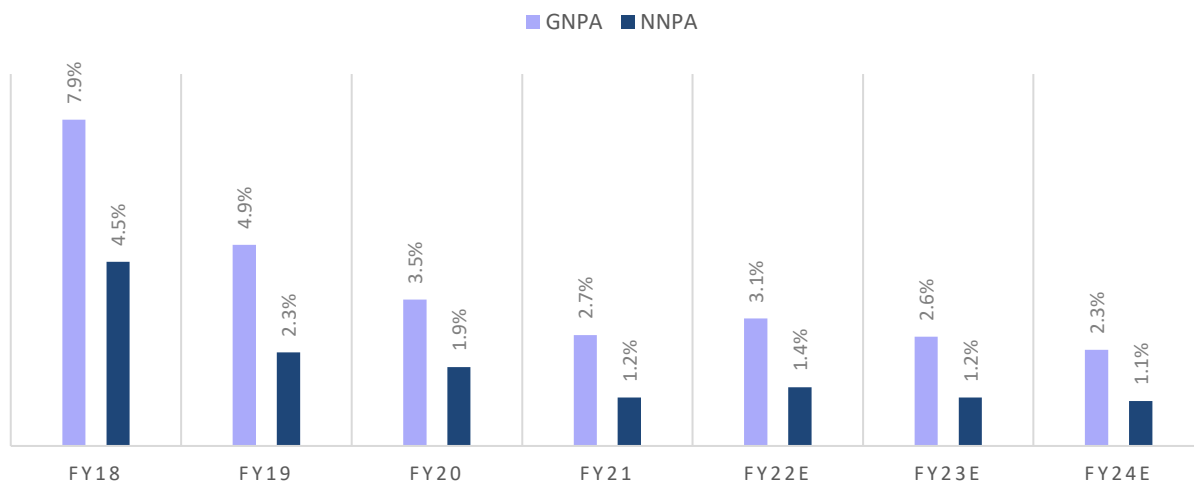
Profitability Ratios



Source: Dalal & Broacha Research, Company

Pictures speak louder than words

(Asset quality cleanup done with limited COVID stress)

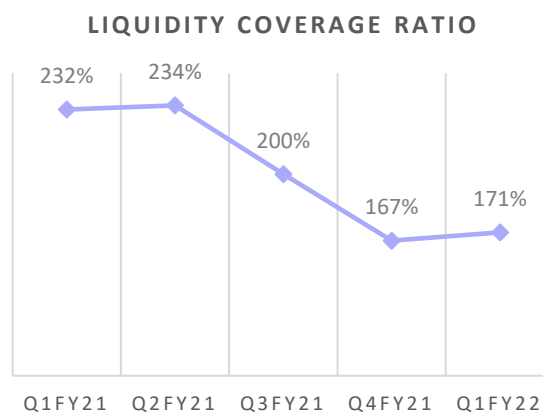
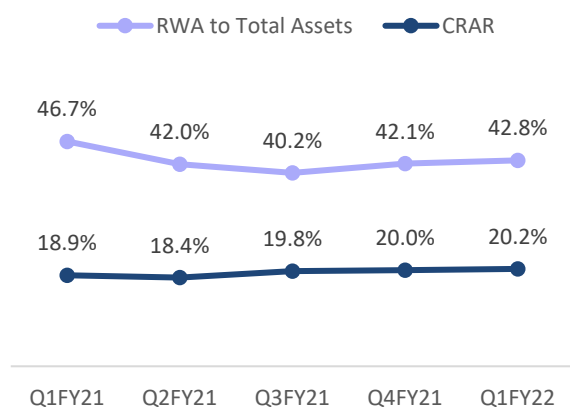


Prudential Provisioning Policy

NPA Provision	Asset Classification		RBI Norms	Bank's Norms
	Sub Standard Assets	Secured		15%
Unsecured			25%	50%
Doubtful Assets (Up to one year)	Secured		25%	50%
	Unsecured		100%	100%
Doubtful Assets (One to three years)	Secured (1st Year)		40%	100%
	Secured (2nd Year)		40%	100%
	Unsecured		100%	100%
Doubtful Assets (More than three years)	Secured/Unsecured		100%	100%
Loss Assets	Secured/Unsecured		100%	100%

Source: Dalal & Broacha Research, Company

Solid CRAR & Adequate Liquidity

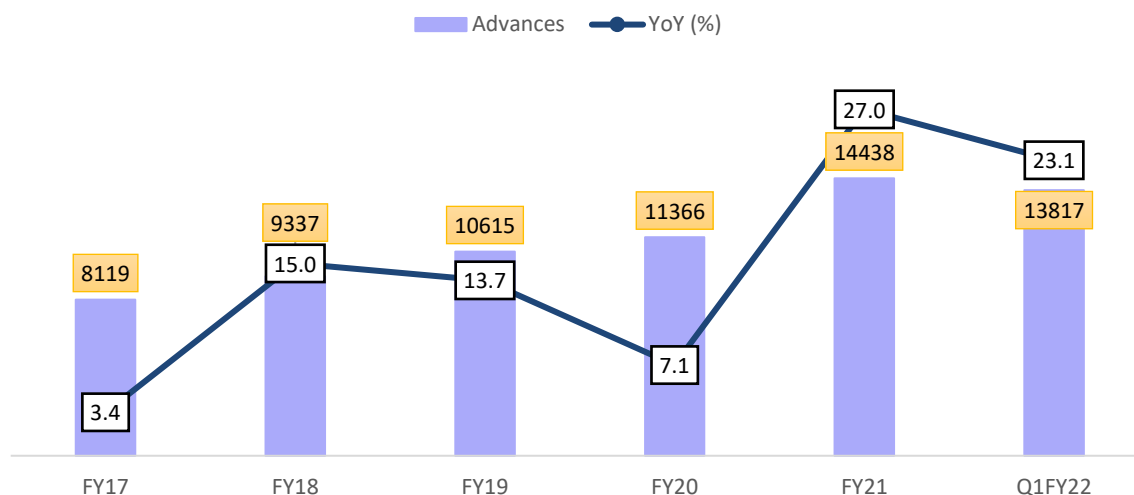


Source: Dalal & Broacha Research, Company

CSB Bank has been transforming within itself since 2016

(Bank has been transforming its leadership and people capabilities, bringing in investor confidence, prudent risk management, streamlining processes, rationalization and strong sales verticalization)

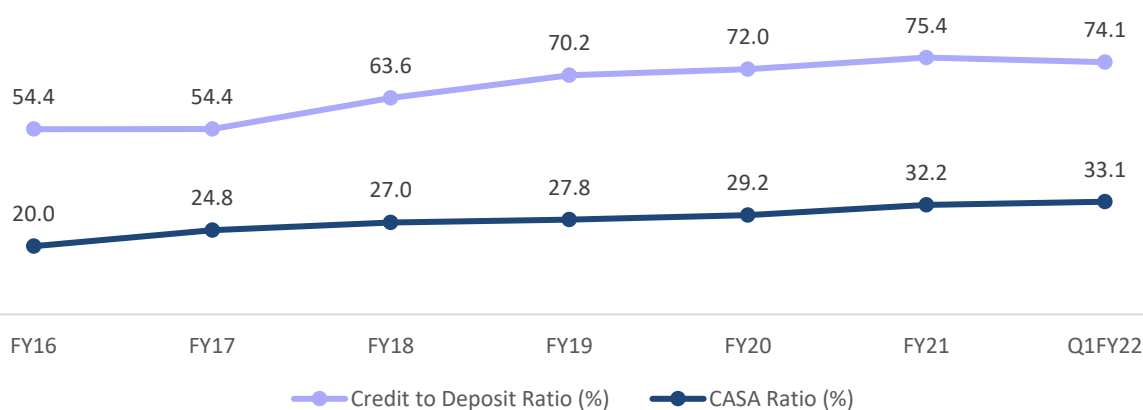
Growth in Advances



Classification of Gross Advances Portfolio

Particulars	FY19	FY20	FY21	Q1FY22
Gold Loans	25.8	31.0	39.8	37.9
SME Loans	21.3	16.8	14.6	13.2
MSME Loans	2.8	2.3	1.9	2.4
Corporate Loans	25.7	27.8	23.7	26.2
Retail Loans	11.7	10.6	7.8	7.8
2-Wheeler Loans	0.2	0.6	1.1	1.2
Agri & MFI	0.3	1.3	3.7	4.3
Assignments	5.5	5.5	4.2	3.4
LCBD & TReDS	6.9	3.9	3.2	3.7

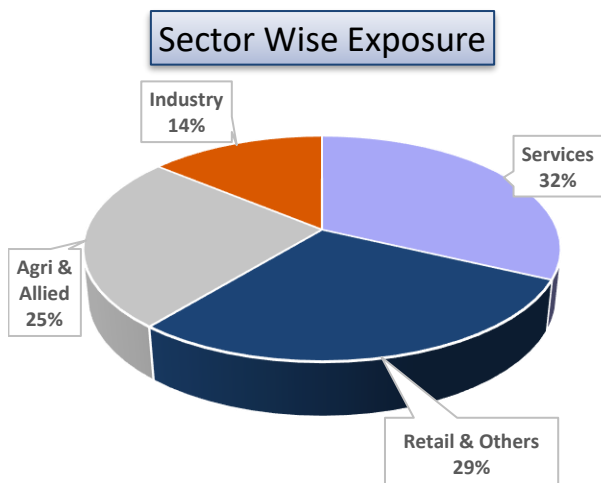
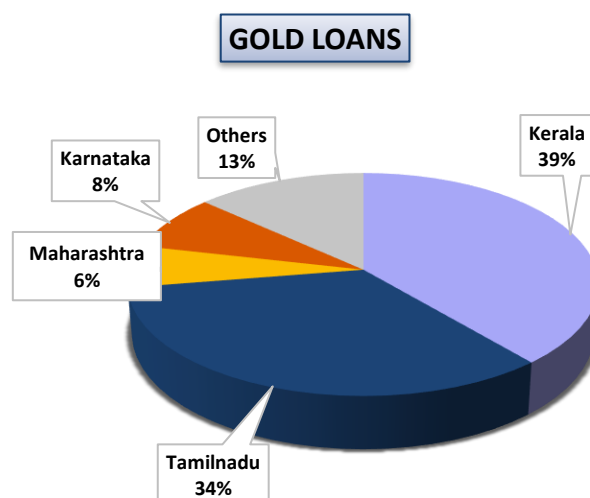
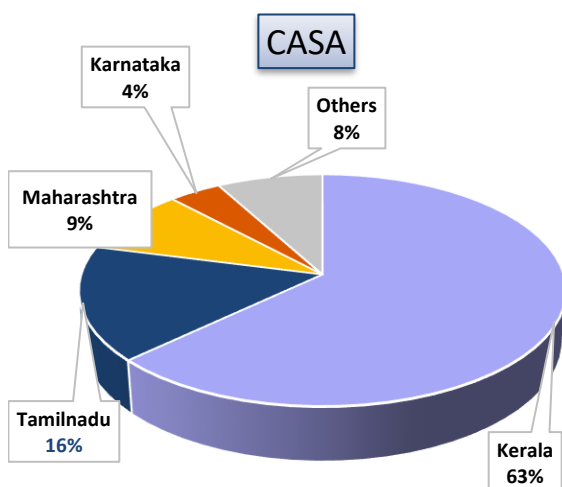
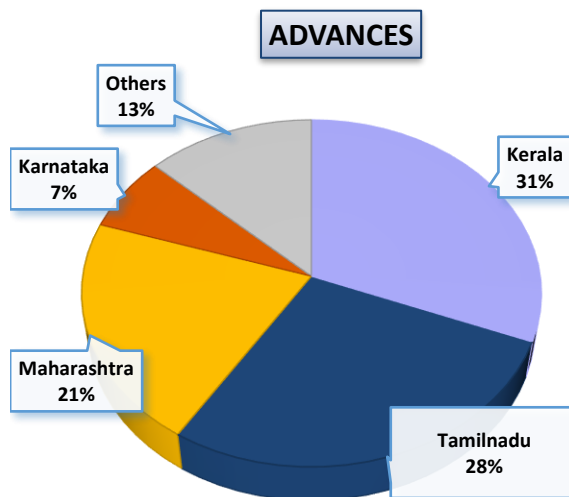
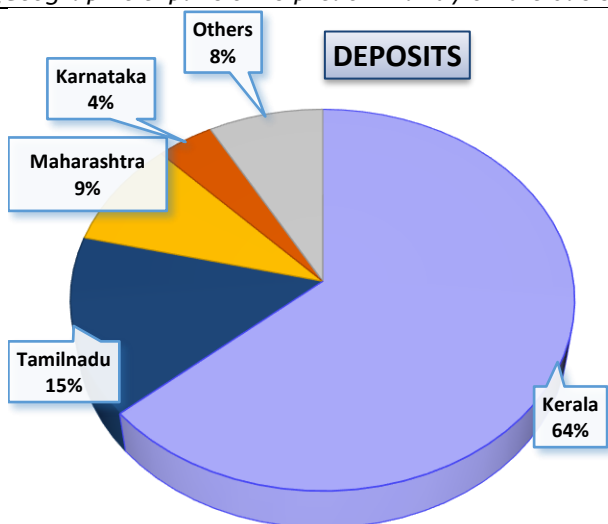
Business Momentum



Source: Dalal & Broacha Research, Company

Geographical Concentration

(Geographic expansion is predominantly on the basis of broad strategy to enhance presence outside Kerala)



Services	As % of gross advances
NBFCs	9.75%
Wholesale & Retail Trade	5.23%
Tourism, Hotel & Restaurants	2.86%
Commercial Real Estate	2.58%
Computer Software	0.48%
Transport Operators	0.36%
Professional Services	0.15%
Other Services	10.04%

Source: Dalal & Broacha Research, Company

Financial

P&L (Rs Bn)	FY20	FY21	FY22	FY23	Ratios	FY20	FY21	FY22	FY23
Interest income	15.10	18.72	22.02	26.32	Growth (%)				
Interest expense	9.18	9.31	10.87	13.33	NII	35	59	18	16
NII	5.92	9.41	11.15	12.98	PPOP	2000	119	8	24
Non-interest income	2.22	4.01	3.80	4.66	PAT	-106	1616	26	42
Net revenues	8.14	13.42	14.96	17.65	Advances	7.1	27	15	24
Operating expenses	5.33	7.29	8.32	9.43	Deposits	4.4	21	19	20
PPOP	2.81	6.13	6.64	8.22	Spread (%)				
Provisions	1.47	3.21	2.98	3.02	Yield on Funds	9.1	9.4	9.1	9.3
PBT	1.34	2.93	3.66	5.20	Cost of Funds	5.8	5.0	4.9	5.1
Tax	1.21	0.74	0.92	1.31	Spread	3.3	4.4	4.3	4.2
PAT	0.13	2.18	2.74	3.89	NIM	3.6	4.7	4.6	4.6
Balance sheet					Asset quality (%)				
	FY20	FY21	FY22	FY23	Gross NPAs	3.5	2.7	3.1	2.6
Share capital	1.74	1.74	1.73	1.73	Net NPAs	1.9	1.2	1.4	1.2
Reserves & surplus	17.87	20.07	22.81	26.70	Provisions	46	56	55	56
Net worth	19.61	21.80	24.54	28.43	Return ratios (%)				
Deposits	157.91	191.40	227.93	274.63	RoE	0.8	10.5	11.8	14.7
Borrowings	7.94	14.26	11.53	8.81	RoA	0.1	1.0	1.1	1.3
Other liability	3.19	5.91	6.04	7.02	Per share (Rs)				
Total liabilities	188.64	233.37	270.04	318.89	EPS	0.7	12.6	15.8	22.4
Fixed assets	2.53	2.69	2.90	3.11	BV	113	126	141	164
Investments	53.60	61.26	73.34	86.32	ABV	100	116	128	150
Loans	113.66	144.38	165.62	205.12	Valuation (x)				
Cash	9.39	17.14	19.88	15.36	P/E	408	24	19	13
Other assets	9.45	7.90	8.30	8.98	P/BV	2.7	2.4	2.1	1.8
Total assets	188.64	233.37	270.04	318.89	P/ABV	3.0	2.6	2.3	2.0

Source: Dalal & Broacha Research, Company

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