

CSB IPO Review Note



Company Introduction - CSB is one of the oldest private sector banks in India with a history of over 98 years and has a strong base in Kerala along with significant presence in Tamil Nadu, Karnataka, and Maharashtra. They offer a wide range of products and services to their customer base of 1.3 million as on March 31, 2019, with particular focus on SME, Retail, and NRI customers. They deliver products and services through multiple channels, including 414 branches (excluding three service branches and two asset recovery branches) and 277 ATMs spread across 16 states and four union territories as on March 31, 2019, and various alternate channels such as micro ATMs, debit cards, internet banking, mobile banking, point of sale services and UPI.

They have four principal business areas, namely, (a) SME banking, (b) retail banking, (c) wholesale banking, and (d) treasury operations

Dates - Nov 22 to Nov 26, 2019

Promoter - The Promoter of our Bank is FIH Mauritius Investments Ltd ("FIHM")/Fairfax India Holdings Mauritius. As on the date of this Draft Red Herring Prospectus, FIHM holds 86,262,976 Equity Shares, representing 50.09% of the issued, subscribed and paid-up equity share capital of our Bank.

Issue Details

Issue Size – Fresh issue of Rs 24 Cr + OFS of Rs 385 Cr = Rs 410 cr at upper band

Average cost of promoter buying is 140, IPO at 195.

Fresh issue – 12,30,769 shares – 24 cr at upper band

OFS – 1,97,78,298 shares – 386 cr

Total 410 cr issue size

Objects of the Offer

The objects of the Offer are to augment Bank's Tier-I capital base to meet Bank's future capital requirements which are expected to arise out of growth in Bank's assets, primarily Bank's loans/advances and investment portfolio and to ensure compliance with Basel III and other RBI guidelines. Further, the proceeds from the Offer will be used towards meeting the expenses of the Offer

Risks

As on March 31, 2017, March 31, 2018, and March 31, 2019, 4.91% or Rs 4,057 million, 3.99% or Rs 3,867 million, and 4.05% or Rs 4,418 million, respectively, of our total advances were unsecured.

Contingent liability of 727 Cr (H1FY20)

Geographical concentration risk - As of March 31, 2019, out of 414 branches ,353 branches were located in southern India (272 branches located in Kerala and 56 branches located in Tamil Nadu) constituting 85.27% of total branch network. As on March 31, 2019, of their total deposits of ₹ 151,239 million, ₹ 101,278 million and ₹ 17,710 million were received from Kerala and Tamil Nadu, respectively, constituting 66.98% and 11.70% of total deposits, respectively. As on March 31, 2019, out of total advances of ₹ 106,152 million, ₹ 33,834 million and ₹ 25,983 million were in Kerala and Tamil Nadu, respectively, constituting 31.87% and 24.48% of total advances, respectively.

As on March 31, 2019, gold loans represented 31% of the total loans outstanding

Strengths

Strong capital base for growth

The Bank's capital position has significantly strengthened post FIHMs investment. Pursuant to a preferential allotment of Equity Shares and warrants to FIHM worth ₹ 7,207.53 million in Fiscal 2019 and the balance amount of ₹ 4,869.29 million in Fiscal 2020, they have a strong capital base for growth acceleration, something which they were not able to accomplish in past due to paucity of capital. As per the Basel III Norms, the CRAR, on March 31, 2019 and September 30, 2019, was 16.70% and 22.77% (including capital conservation buffer), respectively. This is above the minimum prescribed CRAR of 10.875% (including capital conservation buffer of 1.875%) stipulated by the RBI in the Basel III Norms. Capital augmentation post infusion of funds by FIHM helped vitalize the Bank's growth engine.

Strong channel network and trusted brand in South India

They provide products and services primarily through an extensive physical network of branches and ATMs. They operate in 16 States and four Union Territories in India, reaching 1.3 million customers through 412 branches and 290 ATMs, as on September 30, 2019. In addition to physical network, they have made investments in development of alternate channels from time to time. Their alternate channel network comprises of ATM debit cards, internet banking, mobile banking, point of sales ("POS"), QR payments, UPI, 24*7 phone banking, ePassbook, micro ATMs, prepaid (co-branded) cards, and payment gateway services through tie ups. The number of transactions undertaken through Alternate Channel Network has increased from 42.10% in March 31, 2017 to 56.57% in March 31, 2019 and was 64.18% for the six month period ended September 30, 2019, against the branch manual transaction which includes cash, clearing, transfer, RTGS, NEFT done from branches of our Bank ("Branch Manual Transaction"). With over 98 years of history, the bank has also developed a well-recognized and trusted brand in south India, particularly in the states of Kerala and Tamil Nadu, where they have built strong relationships with many of their customers, which have been one of the key growth drivers.

Streamlined risk management controls, policies and procedures

They manage risk by ensuring that advances are adequately secured. As on March 31, 2017, March 31, 2018, March 31, 2019, and September 30, 2019, 95.09% (i.e. ₹ 78,659 million), 96.01% (i.e. ₹ 92,985 million), 95.95% (i.e. ₹ 104,637 million), and 94.85% (i.e. ₹ 108,155 million) respectively, of their

advances were secured .The bank’s efforts in strengthening risk management have improved asset quality. Gross NPAs decreased to 4.87% as of March 31, 2019 from 7.25% as of March 31, 2017. Further, gross NPAs were 2.86% as on September 30, 2019. The net NPAs decreased to 2.27% as of March 31, 2019 from 4.12% as of March 31, 2017. Further, net NPAs were 1.96% as on September 30, 2019, while provisioning coverage ratio was 65.50%, 75.83%, 78.16% and 79.45% in respect of NPAs (including technical write-offs) as of March 31, 2017, March 31, 2018, March 31, 2019, and September 30, 2019, respectively.

Observations from Financial Statements

Particulars (Rs Cr)	FY17	FY18	FY19	6M	Comments
				30-Sep-19	
Cost to Income Ratio	74.49%		97.68%	71.54%	CTI has fallen
GNPA	7.25%	7.89%	4.87%	2.86%	GNPA has fallen significantly
NNPA	4.12%	2.87%	2.27%	1.96%	NNPA has fallen significantly
Deposits	14912	14691	15124	15509	Deposits have increased
Advances	8272	9685	10905	11298	Advances have increased
Advances to Deposit Ratio	55%	66%	72%	73%	Advances to deposit ratio healthy now
Provision Coverage Ratio	-	75.83%	78.16%	79.45%	Provision Coverage Ratio at good levels and on an upward trend
RoE	-3.30%	-8.11%	-4.48%	2.88%	RoE turns +ve in 6MFY20
EPS	-3.37	-7.38	-3.81	3.86	EPS turns +ve in 6MFY20
Book value per share	102.12	90.95	85.12	85.12	BVPS dilution due to capital raise
CASA Ratio	24.78%	27.03%	27.84%	28.19%	CASA healthy + on upward trend
NIMs	2.11%	2.57%	2.80%	3.43%	NIMs healthy + on upward trend
Total advances to 20 largest borrowers	10.85%	13.87%	13.50%	15.47%	Concentration Risk has increased
Deposits from 20 largest depositors	7.06%	5.11%	6.85%	6.97%	Concentration Risk has increased
Networth	546	354	974	1536	Networth has increased
CAR		8.33%	16.70%	22.77%	Healthy CAR due to capital raise

GNPA NNPA on a constant downtrend - +ve

Capital adequacy amongst the highest in its peer group - +ve

NIMs also one of the highest

As of Sept 31, 2019, 94.85% (i.e. ₹ 108,155 million) of their total advances were secured - +ve

Valuation and Peer Comparison

Peer Comparison	NIM	P/E	P/BV	CAR	RoE	CASA	GNPA	NNPA	Mcap (Rs Cr)
CSB	3.43%	25.3	2.3	22.77%	2.88%	28.19%	2.86%	1.96%	3382
Karur Vysya	3.46%	18.0	0.7	15.99%	3.87%	30.00%	8.89%	4.50%	4568
DCB	3.67%	15.5	1.7	16.16%	12.34%	23.00%	2.09%	0.96%	5580
Federal Bank	3.01%	10.5	1.2	14.32%	12.06%	31.55%	3.06%	1.60%	17292
South Indian Bank	2.69%	5.9	0.4	12.10%	-	24.90%	4.92%	3.48%	2000
City Union Bank	4.01%	20.7	3.1	15.49%	15.21%	24.69%	3.41%	1.90%	15827
Peer Set Average	3.38%	16.0	1.6	16.14%	9.27%	27.06%	4.21%	2.40%	

for CSB, EPS annualized (*2) and for others EPS of sept 2019 multiplied by 4

Legend

	CSB's metric better than peers
	CSB's metric less than peers

Conclusion

CSB has posted turnaround results in 6MFY20 and has improved its operational and financial performance. We believe the bank should do well with the recent capital raise and its strong risk management frameworks. On valuation front, at the upper end of the price band, CSB is valued at a 2.31 P/BV and 25.31x P/E. Taking into account huge growth prospects and its comfortable asset quality stock looks attractive for investment. We give **'SUBSCRIBE' rating in the stock for listing gains.**

Long term – No view currently.

IPO Meet Takeaways

I attended the analyst meet and the takeaways are as follows –

Credit costs have come down from 1.6/1.7% to 0.4% now

MSME proportion in SME portfolio to go up as the management sees good yields here and Low NPAs. One team from a leading private bank is joining CSB especially for this.

Staff count reduced from 3000 to now 1900.

Retirement age at 58 now vs 60 earlier.

Cost to income ratio came down significantly in H1FY20 due to high staff costs earlier which have been streamlined now.

Loan book Mix– Gold Loans (33%), SME (30%) and Corporate (25%). Corporate portfolio to come down gradually over a period.

Renewal rate of retail deposits at 98%!

Promoter holding (Fairfax) post issue will be 49.73%. (AS per RBI condition, the promoter will reduce their stake to 15% over 15 years. RBI Rule states that no permission required for promoter to hold 5% in bank and with permission 10% is allowed.)

Outlook – The Company is targeting branch expansion focusing on 1 year break even with the branch's focus on gold loans as for that the resources are much cheaper.