

November 21, 2019

CSB Bank (CSB) is one of the oldest private sector banks in India with a history of over 98 years and a strong base in Kerala along with a significant presence in Tamil Nadu and Karnataka. The bank is promoted by FIH Mauritius Investments Ltd (FIHM). FIHM 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 13 lakh (as on FY19) aided by 412 branches, with focus on SME, retail and NRI customers.

As of September 30, 2019, CSB has advances of ₹ 11298 crore. Geographically, the company has ~83% exposure towards three states viz. Kerala, Tamil Nadu and Karnataka. CSB has 412 branches across 16 states and four union territory with employee base of 3001 as of FY19. The bank has healthy CASA deposits of ~₹ 4372 crore with CASA ratio of 28.2% as of September 30, 2019.

## Retail, SME to remain key growth drivers

CSB aims to fuel its future lending growth by leveraging its expertise in retail, gold & SME. Among retail, the bank has a predominant focus on gold loans with its contribution in total loans on the rise over the years. As of Q2FY20, gold loan was at ₹ 3782 crore, growing at 28% CAGR in FY17-H1FY20 and contributing 33.5% of total advances. Further, the bank plans to foray ahead using multiple channel like 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. Accordingly, SME constitutes 29.5% of advances at ₹ 3361 crore as of September 2019. CSB has ~7600 SME accounts with average ticket size of ₹ 46 lakh.

## Experienced management with strong independent board

CSB's KMP & board have strong reputation within the industry and wide-ranging experience in the BFSI industry, which is seen helping the bank.

## Key risk and concerns

- Geographical concentration acts as a risk
- Increase in NPA could impact earnings
- Volatility in gold prices could impact financials

## Priced at P/BV of 2.2x H1FY20 on upper band

CSB's performance has not been encouraging in the past with rise in NPA level. However, new promoter and strong management brings capital and execution strength on the table which bodes well for future growth as well as earnings. Therefore, we assign a **SUBSCRIBE** recommendation to the stock. Further, at the IPO price band of ₹ 193-195, the stock is available at a P/BV of ~2.2x at the upper band on H1FY20 basis.



### Particulars

#### Issue Details

Issue Opens	22-Nov-19
Issue Closes	26-Nov-19
Issue Size	~₹ 410crore
Fresh Issue	~₹ 24 crore
Offer for Sale	~₹ 386 crore
Price Band (₹)	193-195
No of shares on offer (Crore)	1.97
QIB (%)	75
Non-Institutional (%)	15
Retail (%)	10
Minimum lot size ( no of shares)	75

### Shareholding Pattern (%)

	Pre-Issue	Post-Issue
Promoter & Promoter gr	50.1	38.3
Public/Other	49.9	61.7

### Objects of issue

Object of issue	Amount
a) To utilize proceeds to augment capital base b) receive benefits of listing of equity shares on stock exchanges c) General Corporate Purposes	₹ 410 crore

### Research Analyst

Kajal Gandhi  
kajal.gandhi@icicisecurities.com

Vishal Namolia  
vishal.namolia@icicisecurities.com

Harsh Shah  
shah.harsh@icicisecurities.com

### Key Financial Summary

₹ crore	FY17	FY18	FY19	1HFY20
Net Interest Income	314	385	440	280
PPP	152	74	13	104
PAT	-58	-127	-66	44
BV	67.4	43.7	37.5	89.2
ABV	2.7	11.1	85.3	77.1
P/E (x)	NA	NA	NA	75.9
P/BV (x)	2.9	4.5	5.2	2.2
P/ABV	72.9	17.6	2.3	2.5
RoA (%)	-0.4	-0.8	-0.4	0.5
RoE (%)	-10.6	-35.9	-6.7	2.9

## Company background

CSB Bank (CSB) is one of the oldest private sector banks in India with a history of over 98 years and a strong base in Kerala along with presence in Tamil Nadu, Karnataka, and Maharashtra. The bank is promoted by FIH Mauritius Investments Ltd (FIHM). FIHM is a wholly owned subsidiary of Fairfax India Holdings Corporation. Currently, FIHM holds 86,262,976 equity shares, representing 50.09% of the issued, subscribed and paid-up equity share capital of the bank. The bank offers a wide range of products and services to its customer base, which are at 13 lakh (as on FY19) aided by 412 branches, with focus on SME, retail and NRI customers.

### Exhibit 1: Key Financials

₹ crore	H1FY20	2019	2018	2017
Advances	11,403	10,906	9,685	8,272
Advances Growth (%)	4.6	12.6	17.1	
Networth (₹ crore)	1536.0	974.0	353.6	546.1
Net Interest Income	279.5	440.0	384.8	313.6
Other Income	84.4	135.9	125.4	281.2
Total Revenue	364	576	510	595
Cost to Income Ratio (%)	71.5	97.7	85.4	74.5
Credit Cost (%)	0.3	1.0	2.8	3.0
Profit after tax	44	(66)	(127)	(58)
Capital Adequacy Ratio (%)	22.8	16.7	8.3	10.9
Tier 1 (%)	22.1	16.0	7.9	10.3
Gross NPA (₹ crore)	326	531	764	600
Gross NPA (%)	2.9	4.9	7.9	7.3
Net NPA (₹ crore)	222	241	264	329
Net NPA (%)	2.0	2.3	2.9	4.1
Return on Asset (%)	0.5	-0.4	-0.8	-0.4
Return on Equity (%)	2.9	(6.7)	(35.9)	(10.6)

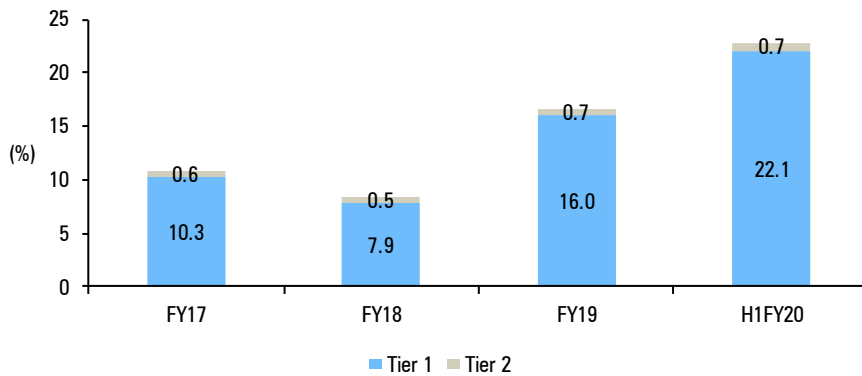
Source: RHP, ICICI Direct Research,

## Investment Rationale

### Adequately capitalised for future growth

CSB’s capital position has been significantly strengthened post capital infusion from FIHM. Pursuant to a preferential allotment of equity shares and warrants to FIHM, CSB received ₹ 720.8 crore in FY19 and balance amount of ₹ 486.9 crore in Q2FY20. The bank has a strong capital base for growth acceleration, which it previously lacked. As per the Basel III norms, the CRAR, as assessed by CSB as on March 31, 2019 and September 30, 2019, was 16.7% and 22.77% (including capital conservation buffer), respectively.

**Exhibit 2: Strong capital adequacy for future growth**



Source: RHP, ICICI Direct Research,

### Trusted brand across South India with strong branch network

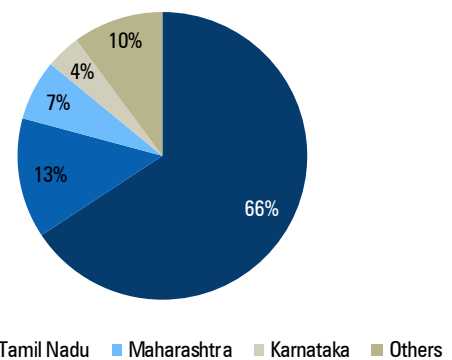
CSB has operations in 16 states and four union territories with a branch network of 412 branches and 13 lakh customers. Over the years, the bank has developed alternate channels to enhance customer’s online banking and digital payment solutions experience. CSB has a strong presence in South India with ~83% branches in Kerala, Tamil Nadu and Karnataka combined. Additionally, with 98 years of history, the bank believes it has developed a well-recognised 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.

**Exhibit 3: Strong distribution network**

Distribution Point	FY17	FY18	FY19	H1FY20
Branches	423	418	414	412
Asset recovery branches	0	0	0	3
Services branches	3	3	3	3
ATMs	257	254	277	290

Source: Company, ICICI Direct Research, RHP

**Exhibit 4: Higher regional concentration**



Source: Company, ICICI Direct Research, RHP

## Retail, SME to remain key growth drivers

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. Over the years, the contribution from gold loans has been on the rise with the proportion of the same at 33.5%. As of Q2FY20, gold loan was at ₹ 3782 crore with ~5.22 lakh accounts (FY19), implying an average ticket size of around ₹ 60,000. The bank's gold loan book has grown at 28% CAGR from ₹ 2030 crore in FY17 to ₹ 3782 crore in H1FY20. CSB has a dedicated team within its retail banking business to focus on gold loan products and has established internal processes. 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.

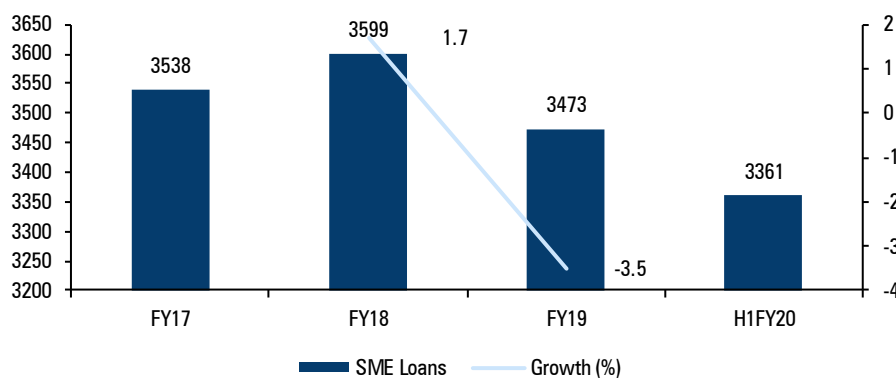
Apart from retail loans, CSB focuses on meeting funding and banking requirements of SME customers. Accordingly, SME constitutes 29.5% of advances to ₹ 3361 crore as of September 2019. The bank has ~7600 SME accounts with average ticket size of ₹ 46 lakh. Further, as on FY19, working capital advances such as cash credit and overdraft facilities to its SME customers constituted 14% of its total advances while terms loans to SME customers constituted 18% of its total advances. As on FY19, 99.3% of its SME loan portfolio is secured by tangible collateral. Lending to SMEs also helps the bank to meet its priority sector lending target. The United Nations Industrial Development Organization (UNIDO) has identified 166 clusters out of 388 SME cluster areas in Tamil Nadu, Andhra Pradesh, Telangana and Gujarat where the bank can expand its SME business.

Exhibit 5: Advances Break-up

	FY17	FY18	FY19	H1FY20
SME	3538	3599	3473	3361
Retail	3638	4035	4895	5272
Corporate	1095	2051	2537	2770
<b>Gross Advances</b>	<b>8272</b>	<b>9685</b>	<b>10906</b>	<b>11403</b>

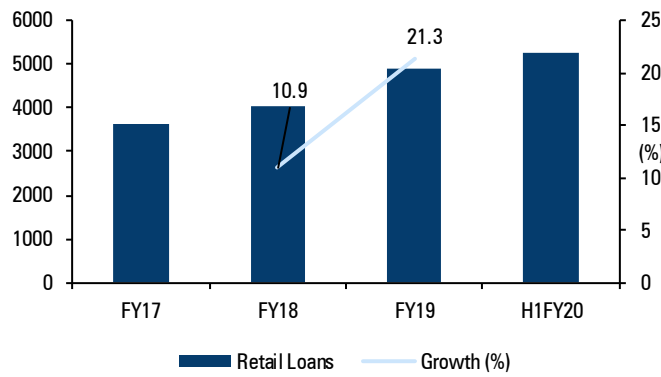
Source: Company, ICICI Direct Research, RHP

Exhibit 6: SME loan growth subdued; to improve ahead



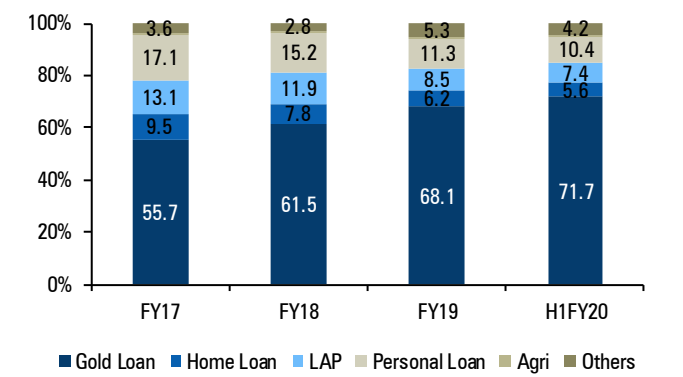
Source: Company, ICICI Direct Research, RHP

Exhibit 7: Retail book growth to loan growth healthy



Source: Company, ICICI Direct Research, RHP

Exhibit 8: Break-up of retail book

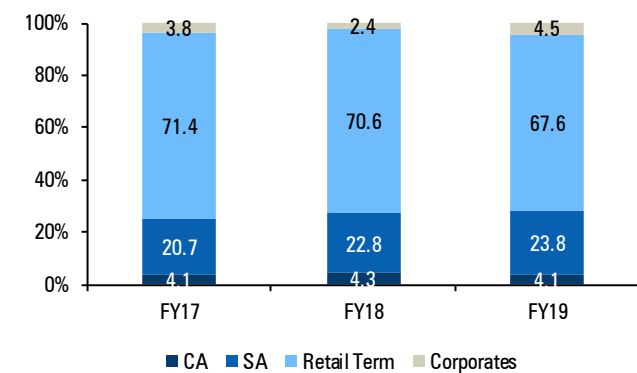


Source: Company, ICICI Direct Research, RHP

### Granular & sturdy deposit franchise

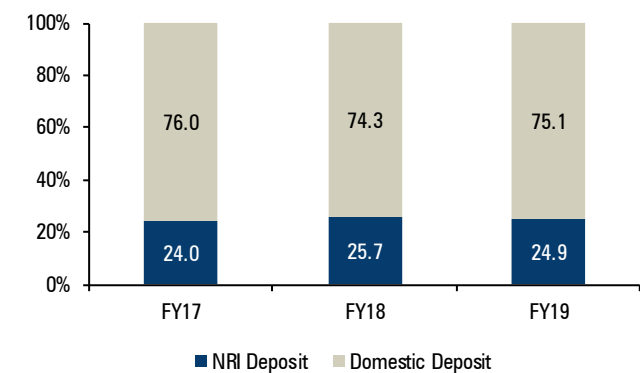
In a bid to reduce the cost of fund, the bank has, over the past three fiscals, been focusing on reducing its high cost term deposit book by shoring up the CASA and NRI book. In accordance with the strategy, deposits have largely been stable at ₹ 15510 crore. However, CASA has increased from ₹ 3695 crore in FY17 to ₹ 4372 crore in H1FY20 while term deposit has declined from ₹ 11199 crore in FY17 to ₹ 10955 crore in H1FY20. CASA ratio as of September 30, 2019 was at 28.2% (24.8% in FY17). NRI deposits have been a stable source of funding for the bank, constituting 23.98%, 25.7%, and 24.9% of total deposit as on FY17, FY18, and FY19, respectively.

Exhibit 9: Focus on gearing up CASA ratio



Source: Company, ICICI Direct Research, RHP

Exhibit 10: NRI deposit remains prominent source of deposit



Source: Company, ICICI Direct Research, RHP

### Experienced management with strong independent board

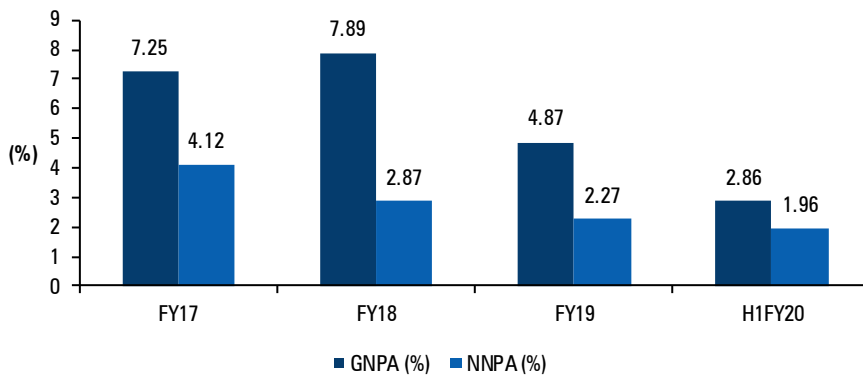
CSB's key managerial personnel, member of board & other senior employees have strong reputation within the industry, extensive industry relationships and wide-ranging experience in the banking and finance industry, which is poised to help the bank grow and evolve. Further, the members of the board have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

### 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. 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 30<sup>th</sup> September 2019 GNPA & NNPA ratio stands at 2.86% & 1.96% respectively.

Exhibit 11: Improved Asset Quality post capital infusion



Source: Company, ICICI Direct Research, RHP

## Key risks and concerns

### Geographical concentration acts as risk

As of FY19, 85.3% of branches are in the south while 65.7% of branches are in Kerala comprising ~67% of overall deposits and 31.9% of the bank's 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. Additionally, the bank continues to expand its operations outside the traditional areas of operation. It faces risks with respect to its operations in new geographical areas in which it does not have expertise.

### Increase in NPA may impact earnings

As of September 30, 2019, GNPA and NNPA were at ₹ 326 crore and ₹ 222 crore, respectively. The GNPA & NNPA ratios declined to 2.86% & 1.96% from 7.89% & 2.87% in FY18, respectively, led by higher write-off and an improving recovery. Going ahead, a continued slowdown in the economy, movements in global commodity markets along with a sharp and sustained rise in interest rates could negatively impact asset quality as ~54% of advances is towards corporate & MSME.

### Volatility in gold prices may impact financials

CSB's significant loan portfolio (31% 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.

## Financial Summary

## Exhibit 12: Profit &amp; Loss Statement

₹ crore	FY17	FY18	FY19	H1FY20
Interest Income	1336	1297	1348	732
Interest Expense	1023	912	908	453
Net Interest Income	314	385	440	280
Other Income	281	125	136	84
Total Income	595	510	576	364
Operating Expense	443	436	563	260
Employee Cost	294	287	384	168
Other Operating expense	150	1	178	92
Operating Profit	152	74	13	104
Provisions	252	269	111	35
Profit Before Tax	-100	-195	-98	69
Tax	-42	-68	-32	25
PAT	<b>-58</b>	<b>-127</b>	<b>-66</b>	<b>44</b>
EPS	-7.2	-15.7	-7.6	2.6

Source: ICICI Direct Research; RHP

## Exhibit 13: Balance Sheet

₹ crore	FY17	FY18	FY19	H1FY20
<b>Liability &amp; Equity</b>				
Equity Share Capital	81	81	86	172
Reserves	465	273	237	1364
Borrowing	42	42	0	0
Other financial liability	271	249	356	277
Deposit	14912	14691	15124	15510
<b>Total Liability &amp; Equity</b>	<b>15770</b>	<b>15335</b>	<b>15802</b>	<b>17323</b>
<b>Asset</b>				
Cash & Bank Balance	1211	1215	322	816
Advances	8001	9185	10615	11298
Investment	5729	4083	4028	4314
Fixed Asset	51	57	60	59
Other Asset	778	795	777	837
<b>Total Asset</b>	<b>15770</b>	<b>15335</b>	<b>15802</b>	<b>17323</b>

Source: ICICI Direct Research; RHP



## Exhibit 14: Key Ratios

	FY17	FY18	FY19	H1FY20
<b>Valuations</b>				
No of equity shares	8.1	8.1	8.6	17.2
EPS (₹)	-7.2	-15.7	-7.6	2.6
BV (₹)	67.4	43.7	37.5	89.2
ABV (₹)	2.7	11.1	85.3	77.1
P/E (x)	NA	NA	NA	75.9
P/BV (x)	2.9	4.5	5.2	2.2
P/ABV (x)	72.9	17.6	2.3	2.5
<b>Yields &amp; Margins (%)</b>				
Net interest Margin	2.1	2.6	2.8	3.4
Yield on Asset	9.1	8.8	9.0	8.8
Cost of Fund	6.9	6.1	6.1	5.9
<b>Quality &amp; Efficiency (%)</b>				
Cost to Income ratio	74.5	85.4	97.7	71.5
GNPA	7.3	7.9	4.9	2.9
NNPA	4.1	2.9	2.3	2.0
ROA	-0.4	-0.8	-0.4	0.5
ROE	-10.6	-35.9	-6.7	2.9

Source: ICICI Direct Research, RHP

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Pankaj Pandey

Head – Research

[pankaj.pandey@icicisecurities.com](mailto:pankaj.pandey@icicisecurities.com)

ICICI Direct Research Desk,  
ICICI Securities Limited,  
1st Floor, Akruiti Trade Centre,  
Road No 7, MIDC,  
Andheri (East)  
Mumbai – 400 093  
[research@icicidirect.com](mailto:research@icicidirect.com)

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