Capital Small Finance Bank

19 June 2024

Well capitalised to accelerate growth

MANAGEMENT MEET UPDATE

Sector: Banks | **Rating: NOT RATED**

CMP: Rs 350 | **Target Price: NA**

Stock Info

Sensex/Nifty	77,337 /23,521
Bloomberg	CAPITALS IN
Equity shares	45mn
52-wk High/Low	Rs 469 / 313
Face value	Rs 10
M-Cap	Rs 15.7bn/ USD 0.19bn
3-m Avg value	USD 0.5mn

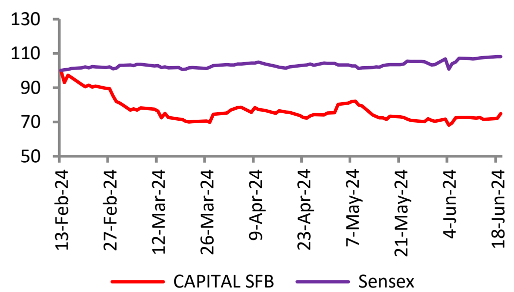
Financial Snapshot (Rs mn)

Y/E March	FY22	FY23	FY24
NII	2,553	3,220	3,452
PPP	1,132	1,487	1,549
PAT	626	936	1,115
PAT Gr. (%)	53%	50%	19%
EPS (Rs)	18.4	27.4	30.4
EPS Gr. (%)	53%	49%	11%
BV/Sh (Rs)	152	178	266
Ratios			
NIM (%)	3.7	4.2	3.9
C/I ratio (%)	63.4	60.0	62.5
RoA (%)	0.9	1.2	1.3
RoE (%)	12.9	16.6	14.6
Valuations			
P/E (x)	NA	NA	11.5
P/BV (x)	NA	NA	1.3

Shareholding pattern (%)

	Mar'24
Promoter	18.9
–Pledged	
FII	1.4
DII	33.1
Others	46.7

Stock Performance



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We recently interacted with the management of Capital Small Finance Bank (Capital SFB) represented by MD and CEO - Mr Sarvjit Singh Samra and CFO – Mr Munish Jain. Key takeaways from the meeting were: (1) Flush from the capital infusion of Rs 5.23bn, post the IPO in Feb'24, the bank is geared towards delivering a loan growth of 22-24% in FY25. FY24 loan growth at 12% was subdued mainly due to the excess leverage on the balance sheet. (2) Management guided for C-D ratio to increase to mid-80's in the medium-term vs 79% average C-D ratio for FY24. (3) With deposit costs broadly stabilized, going forward, margins are expected to increase due to incrementally higher C-D ratio and flow through of MCLR rate hikes taken in 4Q/FY24. (4) The bank currently has presence in the four northern states of Punjab, Haryana, Rajasthan and Himachal Pradesh along with the territories of Chandigarh and NCR. It plans to start business in a new state during this financial year. Haryana is expected to be the next growth driver with product profile and recovery trends like those in its core state of Punjab. Penetration in its core market of Punjab is 1.74% (in 2023), implying headroom for accelerating growth. (5) In FY25, the bank plans to increase the extant branch network of 177 branches by ~ 25 additional branches. Opex to asset ratio is likely to remain around current levels of 2.95% as opex increase from new branch additions will be offset by greater operating leverage stemming from maturity of existing branches. (6) In 4QFY24, GNPA/NNPA, at 2.8%/1.4%, remained broadly stable yoy and improved -21bps / -13bps qoq. NNPA is expected to come below 1% by Sep'25. Historically, while slippage ratio has been ~1.75-2.75%, the bank has maintained low GNPA ratios driven by focus on recoveries and more than adequate collateral cover. (7) The bank delivered FY24 RoA of 1.3% and guided for FY25 RoA to increase to 1.4% on the back of NIM expansion (stemming from on higher leverage) and sweating of existing branch infrastructure. The stock currently trades at trailing P/B of 1.27x for FY24 RoA of 1.3% and RoE of 14.6%.

Loan growth outlook of 22-24% on low base, remains conservative: The bank's key segments include Agri (37% of loans), Mortgages (26%), MSME & trading loans (19%) and Other loans (17%). While the share of MSME advances has declined to 19% in FY24 vs 26% in FY21, due to COVID impact, going forward, the management expects growth to pick-up on the back of 'Make in India' initiatives coupled with the election related uncertainties being behind. The share of corporate book, consisting of loans to NBFCs, increased to 9% in FY24 vs 8% in FY23, and is expected to remain around these levels. In FY24, share of advances from outside Punjab has increased to 17.4% vs 14.81% in FY23. **While FY24 loan growth of 12% yoy was subdued due to constraints from higher leverage, it should normalize to 20%+ levels from FY25. That said, the FY25 guidance of 22-24% (despite a low base) is also soft as compared to key peer SFBs despite a relatively smaller book size of Rs 61bn mainly due to its conservative approach while expanding to newer geographies with the new branch additions likely to be back ended in 2HFY25.**

High retail deposit base, a key strength: The bank's strength is its liability customer base of 0.65 Mn customers which is ~10x its asset customer base. 93% of its liabilities are retail in nature with CASA ratio of 38.3%, highest amongst the listed SFBs. The CASA is also relatively price-inelastic with average SA rate of 3.5% as compared to other mid-sized SFBs offering 7%+ SA rates. The bank continues to gain deposit market share in Punjab with incremental deposit market share of 1.63%, higher than

Investors are advised to refer disclosures made at the end of the research report.

o/s deposit market share of 1.15%. The average deposit ticket size has also increased to Rs 42,000 vs 32,000 three years ago. **With average C-D ratio (79% as of Mar'24) remaining low vs peers, the bank has guided for the C-D ratio to increase to mid-80's in the medium term.**

Margins to be aided by C-D ratio improvement and flow through of MCLR rate hikes: The bank has been able to maintain through-cycle interest spreads between 5.5-5.9% as ~60% of its assets and liabilities are broadly floating, on either side of the balance sheet. While spreads/NIMs (5.6%/3.9%) declined by ~30bps in FY24 due to rising deposit costs, incremental retail TD rates have remained largely stable over the past few quarters (7.65% vs 7.55% a year ago) and with average maturity of the retail TD book being 1 year, **deposit costs have broadly stabilised. Going forward, margin expansion will be led by (i) improvement in C-D ratio which remains low at 79% vs other SFBs having 80-100%+. As per the management, 100bps increase in CDR leads to 5bps NIM expansion. (ii) flow through of MCLR rate hikes as 60-62%of the book is floating rate of which 80% of the book is MCLR linked and 35-40% of it will get repriced in 1Q**. MCLR increased by 35bps in FY24 out of which 25bps was in 4QFY24.

Opex to remain broadly stable on operating leverage: The bank guided for new branch additions of 25 in FY25 taking the total branch count to 200 vs 177 o/s as of Mar'24. However, despite the increased branch count it does not see material increase to opex as (i) opex increase from new branch additions will be offset by operating leverage from maturity of existing branches. (ii) While sourcing is done by branches, underwriting is done at regional, cluster and head-office levels which already have capacity to support 240-245 branches vs 177 o/s branches currently. **In FY25, opex to assets is likely to remain around current levels of 2.95%. Tech spends amount to 0.2% of assets and are unlikely to increase materially** as (i) the bank has already purchased the license (and not a pay as you use model) of its core banking software (Intellect core arena) (ii) large part of its infrastructure is on private cloud, the capex for which is already done.

Strong asset quality driven by focus on recoveries and adequate collateralisation: GNPA/NNPA at 2.8%/1.4% remained broadly stable yoy and improved -21bps / -13bps qoq. FY24 reported credit cost were 0.1% and historical average credit costs have been around ~0.2%, much lower vs other key lenders, mainly due to (i) secured nature of the loan book (ii) strong understanding of its core market (iii) close customer connect as 95% of sourcing is via branch channels and which are also responsible for upselling and recovery. The bank had almost Nil technical write-offs in FY24 and cumulative write-offs so far have been low at <Rs 6Mn, mainly attributable to strong recovery which is entirely in-house. While the bank has PDs (probability of default) between 1.75%-2.75%, it is partly offset by strong recovery rates of around 2%, leading to NNPA of ~1%. That said, SMA 1+2 increased to 4.3% in FY24 vs 3.5% in FY23 mainly due to lower growth and higher interest rates leading to higher EMIs impacting repayments. **PCR for next few years is likely to be around current 50% levels with 30% of the outstanding provisions as additional provisions, over and above the regulatory IRAC requirements. Further, the bank's initial estimates suggest a reduction in provision requirement on implementation of ECL norms. The bank expects Haryana to be the next growth driver and expects recovery trends to be like those in its core state of Punjab**.

The bank's risk underwriting strategy involves (i) nearly, 100% of the loans are secured with average ATS of Rs 1.4mn catering to a target segment of middle-income group customers, having annual income of Rs 0.4mn-4mn. (ii) In the **Agri segment (37% of loans),** the bank targets customer segment with ticket size between Rs 0.5mn-2.5mn which ringfences it from political uncertainty. Primary security is in the form of the standing crop and secondary collateral is a legal mortgage of the Agri land. The bank provides loan with LTV of 50% with the collateral valued at the ready reckoner rate which is lower than the market rate. The bank has not sold off any agri assets till date. (iii) in **mortgages**, the bank collateralizes a residential property only when the borrower possesses ownership title of the property for a minimum of 14 years and at LTV around ~70-75%. (iv) in **MSME**, in addition to a collateral, the bank also has security in the form of asset purchased with the loan like the machinery, stock/good purchased (v) in **NBFC lending**, the bank lends primarily to BBB+ and above rated non-MFI NBFCs. It also has a 5-10% FLDG arrangement for the lower rated NBFCs. (vi) **consumption loans** are given only to the bank's existing customers.

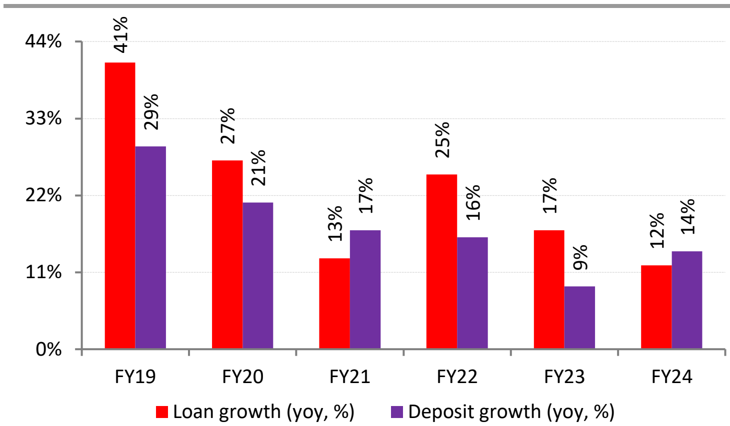
Key charts

Exhibit 1: Credit portfolio

	Agricultural Loans (37%)	Mortgage Loans (26%)	MSME & Trading Loans (19%)	Other Loans (17%): Corporate loans	Other Loans (17%): Consumption & other loans
	• Kisan Credit Card • Agricultural Term Loan	• Housing Loan • Loan Against Property	• Working Capital facility (CC / OD/WCTL) • Project Financing • Machinery Loans	Corporate loans: • Term loans to NBFCs • Term Loans to MFIs	Consumption & other loans: • Auto Loans • Personal Loans • Gold Loans
Gross Advances	**Rs. 2,293 crores** as of March 2024 **Rs. 2,137 crore** as of March 2023	**Rs. 1,624 crores** as of March 2024 **Rs. 1,434 crore** as of March 2023	**Rs. 1,182 crores** as of March 2024 **Rs. 1,120 crore** as of March 2023	**Rs. 566 crores** as of March 2024 **Rs. 425 crore** as of March 2023	**Rs. 495 crores** as of March 2024 **Rs. 391 crore** as of March 2023
ATS	**Rs 12.4 lakhs**	**Rs 11.7 lakhs**	**Rs 18.6 lakhs**	**Rs. 1,719 lakhs**	**Rs 7.9 lakhs**
NNPA	**1.69 %** as of March 2024 **1.40 %** as of March 2023	**0.86 %** as of March 2024 **0.63 %** as of March 2023	**2.73 %** as of March 2024 **3.14 %** as of March 2023	**NIL** as of March 2024 **NIL** as of March 2023	**0.35 %** as of March 2024 **0.33 %** as of March 2023
Interest Yield	**12.08%** as of March 2024 **12.02%** as of March 2023	**11.81%** as of March 2024 **11.72%** as of March 2023	**10.74%** as of March 2024 **10.66%** as of March 2023	**11.15%** as of March 2024 **11.01%** as of March 2023	**9.72%** as of March 2024 **9.39%** as of March 2023

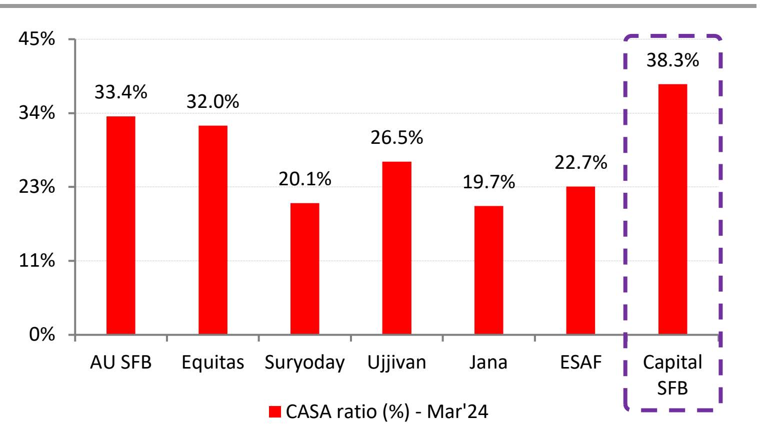
Source: Company, Systematix Institutional Research

Exhibit 2: FY25 loan growth to normalize to 22-25% yoy



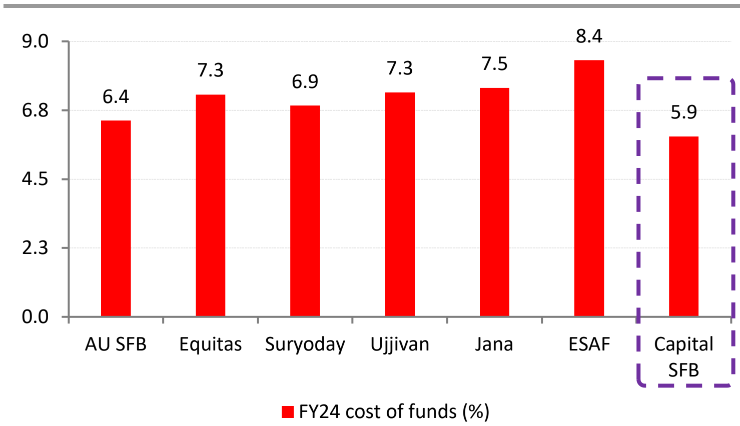
Source: Company, Systematix Institutional Research

Exhibit 3: Highest CASA ratio amongst peer SFBs



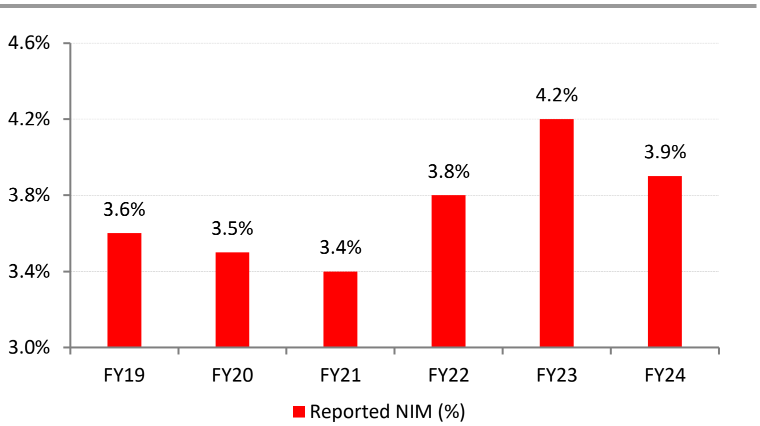
Source: Company, Systematix Institutional Research

Exhibit 4: Lowest cost of funds (amongst SFBs) backed by strong liability franchise



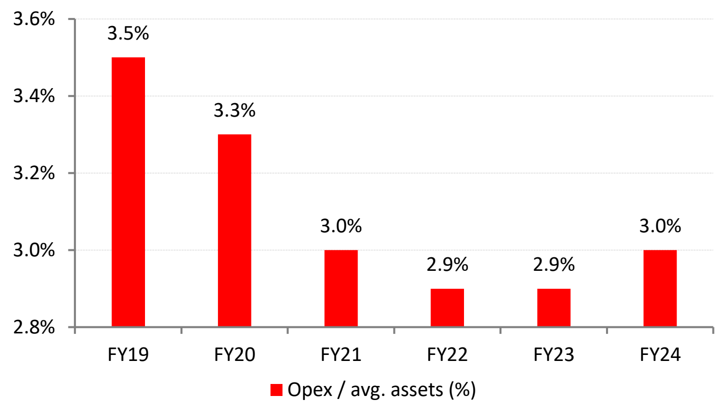
*Source: Company, Systematix Institutional Research *on calculated basis*

Exhibit 5: FY25 NIM to increase on higher CDR and impact of recent MCLR hikes



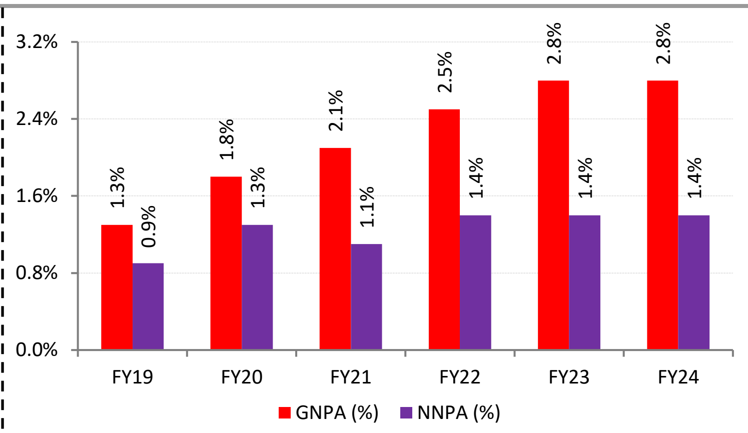
Source: Company, Systematix Institutional Research

Exhibit 6: Opex/avg assets to remain around current levels



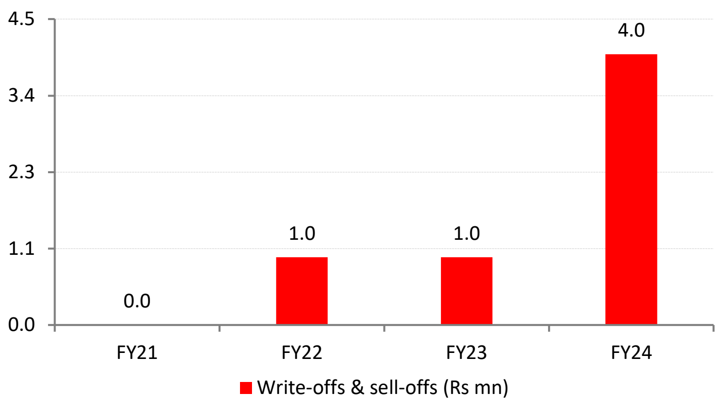
Source: Company, Systematix Institutional Research

Exhibit 7: Stable NNPA trends led by strong focus on recoveries



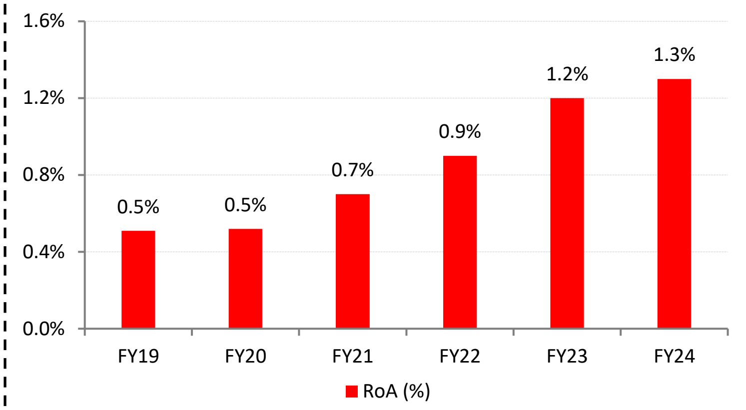
Source: Company, Systematix Institutional Research

Exhibit 8: Almost NIL write-offs led by emphasis on collections/recoveries



Source: Company, Systematix Institutional Research

Exhibit 9: RoA to expand to 1.4% in FY25



Source: Company, Systematix Institutional Research

Exhibit 10: Peer Comparison (as of FY24)

Banks	AU SFB	Ujjivan	Equitas	Capital SFB	Suryoday	Jana	ESAF	IDFC First	CUB	Federal Bank	TMB	KVB	RBL Bank	YES Bank
Loan growth (%)	25.2	26.3	20.0	11.9	34.3	30.1	31.4	28.2	5.7	20.0	6.6	16.7	19.6	12.1
Deposit growth (%)	25.7	23.2	42.3	14.0	50.5	38.2	35.5	38.7	6.2	18.3	3.7	16.3	21.9	22.5
LDR (%)	83.9	85.4	85.7	81.2	103.9	102.4	92.1	97.0	81.8	82.9	80.2	82.7	81.2	85.5
Leverage ratio (%)	8.5	7.5	7.2	9.6	6.6	10.9	15.7	10.5	8.7	11.2	8.1	10.5	9.0	9.2
CASA Ratio (%)	33.4	26.5	32.0	38.3	20.1	19.7	22.7	47.2	30.6	29.4	29.6	30.4	35.2	30.9
Asset yields (%)	10.8	15.9	14.2	9.4	14.9	14.1	17.0	11.9	8.0	8.4	8.6	8.7	10.5	8.7
Cost of funds (%)	6.4	7.3	7.3	5.9	6.9	7.5	8.4	6.1	5.4	5.5	5.3	5.2	5.9	6.1
NIM (%)	5.3	9.5	8.0	4.1	9.0	7.5	10.7	6.5	3.2	3.1	3.8	4.0	5.1	2.5
Cost to income ratio (%)	63.6	54.3	64.5	62.5	61.6	57.4	58.6	72.2	47.1	54.5	47.0	48.3	66.6	74.4
Credit costs (%)	0.7	0.9	1.1	0.1	2.4	3.3	3.7	1.4	0.6	0.1	0.2	1.1	2.3	0.9
RoA (%)	1.6	3.5	2.0	1.3	1.9	2.3	1.8	1.1	1.5	1.3	1.8	1.6	0.9	0.3
RoE (%)	13.7	26.1	14.4	14.6	12.7	24.9	28.9	11.6	12.8	14.7	14.6	17.2	8.2	3.0
GNPA Ratio (%)	1.7	2.2	2.6	2.8	2.8	2.1	4.8	1.9	4.0	2.1	1.4	1.4	2.7	1.7
NNPA Ratio (%)	0.6	0.3	1.2	1.4	0.8	0.6	2.3	0.6	2.0	0.6	0.9	0.4	0.7	0.6
PCR (%)	67.6	87.5	56.1	50.0	71.2	73.7	53.7	68.8	51.5	72.3	41.6	71.4	72.7	66.6
NNPA to Equity (%)	3.2	1.4	6.0	7.1	3.9	3.6	16.6	3.6	10.7	4.3	4.2	3.0	4.2	3.2
CAR - BASEL III (%)	20.1	24.7	21.7	27.4	28.4	20.3	23.3	16.1	23.8	16.1	29.4	16.7	16.2	15.4
Tier 1 (%)	18.8	22.6	20.7	22.8	26.5	19.0	19.7	13.4	22.8	14.6	28.0	15.5	14.4	12.2
Tier 2 (%)	1.3	2.1	1.0	4.6	1.9	1.3	3.6	2.7	1.0	1.5	1.4	1.2	1.8	3.2
Branch	476	752	964	177	695	808	753	944	800	1,504	552	838	545	1,453

*Source: Company, Systematix Institutional Research *ratios are on calculated basis*

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Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24
Interest Earned	5,114	5,782	6,760	7,943
Interest Expended	3,128	3,229	3,540	4,492
NII	**1,986**	**2,553**	**3,220**	**3,452**
Other Income	458	542	495	681
Total Income	**2,444**	**3,095**	**3,715**	**4,132**
Operating Expenses	1,730	1,963	2,228	2,583
PPOP	**715**	**1,132**	**1,487**	**1,549**
Provisions	177	287	245	67
PBT	**537**	**845**	**1,242**	**1,482**
Tax	130	219	306	367
PAT	**408**	**626**	**936**	**1,115**

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24
Capital & Liabilities				
Capital	339	340	343	450
Reserve and Surplus	4,169	4,817	5,764	11,524
Deposits	52,211	60,464	65,606	74,777
Borrowings	6,167	4,984	7,214	4,723
Other Liabilities and provisions	827	934	982	1,479
Total	**63,712**	**71,539**	**79,908**	**92,953**
Assets				
Cash and Balances with RBI	7,217	3,640	4,627	5,690
Balances With banks and Money at call and Short Notice	5,687	6,551	4,182	7,522
Investments	12,123	13,571	14,886	17,057
Advances	37,269	46,348	54,287	60,747
Fixed assets	866	836	826	837
Other Assets	551	594	1,101	1,100
Total	**63,712**	**71,539**	**79,908**	**92,953**

Source: Company, Systematix Institutional Research

Dupont (%) on Average total assets

YE: Mar	FY21	FY22	FY23	FY24
Interest Earned	8.7%	8.6%	8.9%	9.2%
Interest Expended	5.3%	4.8%	4.7%	5.2%
NII	**3.4%**	**3.8%**	**4.3%**	**4.0%**
Other Income	0.8%	0.8%	0.7%	0.8%
Total Income	**4.2%**	**4.6%**	**4.9%**	**4.8%**
Operating Expenses	3.0%	2.9%	2.9%	3.0%
PPOP	**1.2%**	**1.7%**	**2.0%**	**1.8%**
Provisions	0.3%	0.4%	0.3%	0.1%
PBT	**0.9%**	**1.2%**	**1.6%**	**1.7%**
Tax	0.2%	0.3%	0.4%	0.4%
PAT (RoAA)	**0.7%**	**0.9%**	**1.2%**	**1.3%**
RoE	**9.5%**	**12.9%**	**16.6%**	**14.6%**

Source: Company, Systematix Institutional Research

Key Metrics (%)

YE: Mar	FY21	FY22	FY23	FY24
Yields (% of IEA)	8.2%	8.7%	9.1%	9.4%
Reported Cost of Deposits (%)	5.7%	5.0%	4.9%	5.6%
Reported NIM (%)	3.4%	3.8%	4.2%	3.9%
CASA ratio (%)	40.1%	42.2%	41.9%	38.3%
Retail deposit (%)	97.6%	97.4%	97.9%	92.9%
LCR (%)	454%	309%	210%	249%
CRAR (%)	19.8%	18.6%	18.9%	27.4%
Tier - 1 (%)	14.3%	13.2%	13.7%	22.8%
GNPA (%)	2.1%	2.5%	2.8%	2.8%
NNPA (%)	1.1%	1.4%	1.4%	1.4%
PCR (%)	46.1%	46.0%	51.5%	50.0%
Tax rate (%)	24.1%	25.9%	24.6%	24.7%
Reported credit costs (%)	0.3%	0.4%	0.3%	0.1%
Opex to assets (%)	3.0%	2.9%	2.9%	3.0%
Reported CDR (%)	67.5%	70.6%	78.0%	79.0%
Cost to income (%)	70.8%	63.4%	60.0%	62.5%

Source: Company, Systematix Institutional Research

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