

KARNATAKA BANK

BANKING

Q2FY18: Operating parameters stable; higher credit costs dents profitability;

Karnataka Bank (KBL) operating parameters were strong on all fronts with loan growth acceleration, margins improvement, strong fee income growth and moderation in slippages. Commentaries on each of the above key parameters remain encouraging. Higher credit costs however impacted profits during the quarter. Capital position remains strong. With huge liquidity in terms of deposits, the new management with focus on credit growth along with branch expansion envisages business growth of 17% by FY18 to Rs 1,10,000 cr.

Outlook

Though still at a nascent stage of transformation, KBL has made strong in-roads in RoE improvement. The transformational exercise as envisaged will further augment overall RoE's. KBL's vision 2020 targets the business turnover of Rs 1,80,000cr by FY20 with deposits of Rs 1,00,000cr and advances of Rs 80,000cr to be driven by higher growth in the retail portfolio (60% of advances). Also, KBL aims to become a Preferred Banker to atleast 1% of India's population by FY20. We retain our buy rating and assign P/ABV of 1.05x arriving at a target price of Rs 195/share.

BUY

Target Price: Rs195

CMP : Rs159
Potential Upside : 23%

MARKET DATA

No. of Shares : 28.27cr
FV (Rs) : 10
Market Cap : Rs 4,873cr
52-week High / Low : Rs176 / Rs90
Avg. Daily vol. (6mth) : 40,79,178 shares
Bloomberg Code : KBL IN
Reuters Code : KBNK.BO
BSE Code : 532652
NSE Code : KTKBNK

Key Highlights

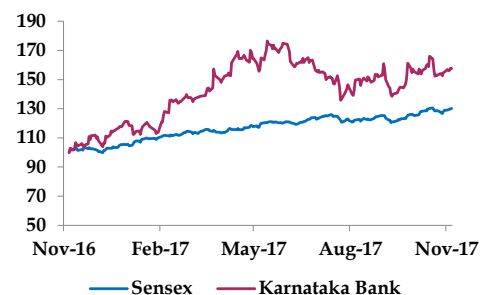
- Asset quality improves:** Asset quality was maintained with G/NNPAs at 4.1/3%, down from 4.3/3.2% in Q1FY18. Slippages at Rs 374cr (0.9% annualized vs. 1.3% in Q1FY18) included one account of Rs 230cr from housing-infra space that was downgraded to NPA following aggressive NPA recognition policy. This account was earlier part of SDR and the bank has made 25% provision against this account. Standard restructured loans stood at Rs 690cr and coupled with GNPA, SDR and S4A make for 6.5% of loans (vs. 8.6% in FY17). G/NNPA target for FY18 is retained at 4% and 2% respectively.
- Credit costs up:** Provisioning increased during the quarter to Rs 226cr from Rs 199cr QoQ on front loading of provisioning done for an infrastructure account it has treated as an NPA. Credit costs went up to 2.2% from 2.1% resulting in lower PAT of Rs 93cr (down 30% QoQ).
- CASA stable:** Deposits grew 6.5% led by 15.6% YoY growth in CASA deposits. The cut in SA deposits effective August, 2017 has positively impacted NIM by 10bps. CASA was largely stable at 28.58% (28.94% in Q1FY18).
- NIMs improved YoY:** NII at Rs 440cr was up 11% YoY led by 12% growth in loans and NIM expansion to 3.03% (2.62% in Q1FY18). Non-interest income too came in higher (fees grew 36% YoY; treasury were up 21% YoY) and with stable costs saw operating profit grow 57% to Rs 366cr. Buoyancy in the loan book was maintained by growth in retail book (~11% YoY). The management has guided for business growth of 17% by FY18 to Rs.1,10,000cr with focus on retail portfolio.

FINANCIAL SUMMARY

Y/E	NII	PAT	EPS	Change	BV	P/E	P/BV	Net NPA	ABV	P/ABV	RoE (%)	RoA (%)
Mar	(Rs Cr)	(Rs Cr)	(Rs)	(%)	(x)	(%)	(%)	(%)	(Rs.)	(x)		
FY16	1,303	415	22.0	-8	196	6.9	0.8	2.35	153	1.0	11.7	0.8
FY17	1,491	452	16.0	-27	182	6.9	0.8	2.64	147	1.0	10.2	0.7
FY18E	1,786	569	20	25	197	8.0	0.7	2.14	164	1.0	10.6	0.8
FY19E	2,174	769	27	35	219	5.9	0.6	1.83	186	0.9	13.1	1.0

Source: Company and Axis Securities

PRICE PERFORMANCE



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Results Update

	Sep-17	Sep-16	% YoY	Jun-17	%QoQ	FY17	FY18E	FY19E
Interest Income	1,318	1,306	1%	1,331	-1%	3,891	5,905	6,802
Interest Expenses	878	909	-3%	906	-3%	2,752	4,119	4,628
Net Interest Income	440	397	11%	424	4%	1,138	1,786	2,174
Other Income	248	190	31%	217	14%	498	676	781
Total Income	688	587	17%	642	7%	1,636	2,462	2,955
Operating Expenses	322	354	-9%	332	-3%	970	1,317	1,507
Employee	124	174	-28%	137	-10%	478	777	889
Others	198	181	9%	195	2%	491	540	618
Operating Profits before provisions	366	233	57%	310	18%	667	1,145	1,448
Total Provisions	226	131	73%	199	14%	367	386	423
PBT	140	102	37%	111	27%	299	759	1,025
Taxes	47	(22)	-	(23)	-	(15)	190	256
PAT	93	124	-25%	134	-30%	314	569	769
EPS	3	7	-	5	-	11	20	27
Asset Quality								
GNPA Rs. Cr	1,716	1,345	28%	1,691	1%	1,560	1,529	1,521
NNPA Rs. Cr	1,247	961	30%	1,230	1%	1,066	918	912
GNPA %	4.13	3.64	-	4.34	-	4.30	3.50	3.00
NNPA %	3.04	2.63	-	3.20	-	2.99	2.14	1.83
Slippages	374	233	61%	498	-25%	837	728	1,100
Slippage Ratio %	0.91	0.64	-	1.29	-	2.34	3.0	2.45
Restructured Assets	1,028	1,459	-30%	1,140	-10%	1,330	1,000	800
Credit Cost %	2.2	1.4	-	2.1	-	1.0	0.9	0.9
Ratios %								
Cost to Income ratio	46.8	60.3	-	51.7	-	59.3	53.5	51.0
Loan/Deposit	72.7	69.0	-	68.4	-	62.3	65.2	66.4
CASA %	28.6	26.3	-	28.9	-	30.2	27.6	27.6
RoA %	0.7	0.8	-	0.8	-	0.7	0.8	1.0
RoE %	8.7	12.9	-	10.3	-	9.5	10.6	13.1
CAR (Basel III) %	12.5	11.2	-	13.0	-	13.2	12.8	12.5
Tier I %	11.4	9.8	-	11.9	-	11.9	12.0	11.7
Tier II %	1.0	1.4	-	1.1	-	1.3	0.8	0.8
Margins %								
Yield on Advances	10.2	11.1	-	10.2	-	11.1	11.1	10.8
Cost of Deposits	6.2	6.9	-	6.3	-	6.8	6.8	6.5
Quarterly NIMs	3.0	2.6	-	2.6	-	2.5	2.45	2.5
BV-Calculated								
BV-Calculated	187	209	-	187	-	165	197	219
Adjusted Network	4,043	2,975	-	4,047	-	3,599	4,642	5,266
Adj. BV	143	158	-	143	-	127	164	186
Balance sheet								
Capital	283	188	50%	283	0%	283	283	283
Net Worth	5,290	3,936	34%	5,276	0%	4,665	5,560	6,178
FV	10	10		10		10	10	10
Deposits	56,558	53,096	7%	56,227	1%	57,435	65,810	75,024
Investments	16,734	16,736	0%	18,421	-9%	16,734	23,050	26,278
Loans	41,127	36,611	12%	38,484	7%	35,786	42,924	49,792

Source: Company and Axis Securities

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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