Karnataka Bank Ltd.

"Improving business outlook; available at cheap valuation"

BUY

Sep 29, 2017

Karnataka Bank Ltd. (KBL), incorporated in 1924, is one of the oldest private sector banks in India. With the 769 branches and 1,398 ATMs spread across India and employee strength of 7,982, the bank provides entire spectrum of the financial services to customer segments covering large and mid-corporates, MSME, agriculture and retail businesses. As the name suggests, KBL is a Karnataka based bank driving major business from the home state on the back of extensive presence with 62% of branches locating in state. KBL attained a balance sheet size of Rs641 bn in FY17 with a five year CAGR of 11.5% in total assets & 11.2% in business size. KBL is likely to emerge far stronger over the next few years and its business growth to be driven by management's focus on increasing low cost deposits (CASA deposits), improving C/D ratio and shifting the business mix toward the retail and SME segments. Under the VISION 2020, the management has set target to double the bank's business size to Rs1,800 bn by FY20 (Rs937.4 bn in FY17) with C/D ratio at 80% and to become the preferred banker of at least 1% of Indian population. We prefer KBL mainly owing to its consistence performance and initiatives taken by management to further improve the business as well as profitability. We initiate coverage on KBL with a 'BUY' rating at a potential price of Rs213 per share, which implies upside of 52.1% to the CMP.

Investment Rationale:

1) Optimistic over assets quality outlook; high recovery than slippage to reduce bad loans accumulation …… (Page 2-6)

2) Business likely to grow at higher pace; factoring 15.5% CAGR in advances over FY17-F19E ….. (Page 6-7)

3) Margins expecting to increase going forward …….(Page 10)

4) C/I ratio likely to improve driven by improvement in the operating efficiencies …….(Page 11-12)

5) Well capitalized; KBL able to fund assets growth ….. (Page 12)

Valuation:. We are positive on KBL's business outlook and our optimism are driven by following factors including –

- Improving assets quality outlook
- High likelihood of strong credit growth
- Enhanced focus on retail, SME clients and fee income growth
- Well capitalized, enabling the bank to fund assets growth
- Improving operating efficiencies.

We value the stock at P/ABV multiple of 1.2(x) to FY19E adjusted book value of Rs177.7 per share and arrived at potential price of Rs213 per share.

Rating Matrix	
CMP	Rs140
Rating	Buy
Potential Price	Rs213
Holding Period	12 - 18 Months
Upside Potential	52.1%
52 week H/L	Rs181/100
Face value	Rs10
Mar. Cap.	Rs39,566.8 mn
Category	Mid Cap
Sector	Banking

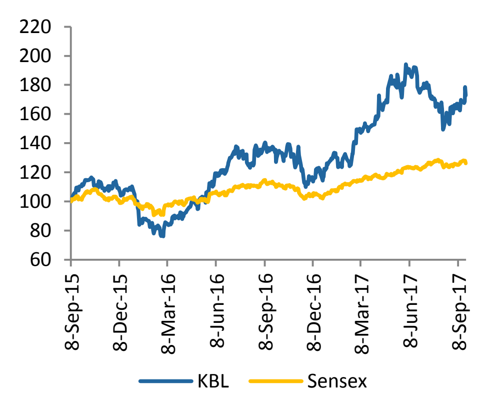
Shareholding Pattern

Particulars	Jun'17	Mar'17	Dec'16	Sep'16
Promoter	0%	0%	0%	0%
FPIs	*21.9%*	*19.2%*	*20.2%*	*23.0%*
Insti.	31.9%	30.8%	28.7%	31.9%
N. Insti.	68.1%	69.2%	71.3%	68.1%

Key Financials (Rs bn)

Particulars	FY16	FY17	FY18E	FY19E	FY20E
NII	13.0	14.9	17.9	20.4	25.0
Gr. (%)	7.0%	9.1%	14.2%	17.0%	17.7%
NIM	2.61%	2.72%	2.90%	2.92%	3.13%
PPOP	8.5	10.0	11.8	13.3	16.5
A.PAT	4.2	4.5	5.3	6.4	8.1
Eq./As. (%)	6.5%	8.0%	7.8%	7.4%	7.2%
RoE (%)	11.7%	10.2%	9.9%	11.1%	12.8%
CASA(%)	26.3%	29.0%	29.8%	31.4%	32.9%
P/ABV (x)			0.9	0.8	0.7

Relative Capital Market Strength



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Karnataka Bank Ltd.

Banking

Business Overview: KBL generated ~73% of its interest income from the advances and 25% from the investments in FY17. On segment wise, the bank garnered 27.4% of operating revenue from the treasury, 30.3% from wholesale/corporate banking, 38.1% from retail banking and the balance or 4.3% from other banking operations. Advances book of KBL is well diversified over retail, wholesale, SME and agriculture sector. Below Rs5 cr of advance which the banks considered as retail, consists of major chunk or 47.5% of advances book by FY17, while, corporate, SME and Agriculture accounted for 12.1%, 26.1% and 14.4% of the KBL's loan book in the same fiscal.

High yielding, low risk retail is the largest segment of the bank under which it provides its target market customers a full range of banking services and financial products ranging from various deposits products and retail loans such as auto loans, personal loans & credit card, and home loans etc. CASA ratio or low deposits base of bank increased to 29.0% by FY17 from 25% in FY15, while the other key financial ratio i.e. RoE(%) stood at 10.2%, GNPA (%) at 4.2% and C/I ratio at 56.7% by FY17. The bank is well capitalized with CAR ratio at 13.0% and tier I capital at 11.9%. During the year, the bank came with the right issue in the ratio of 1:2, has allotted 94.4 million (mn) of equity shares of Rs10/- each at a premium of Rs60 per share aggregating to Rs6,589.6 mn.

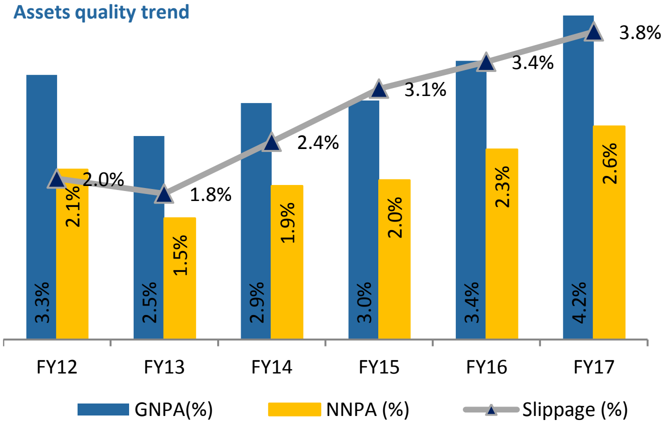
Investors Rationale

1) Optimistic over assets quality outlook; high recovery than slippage to reduce bad loans accumulation

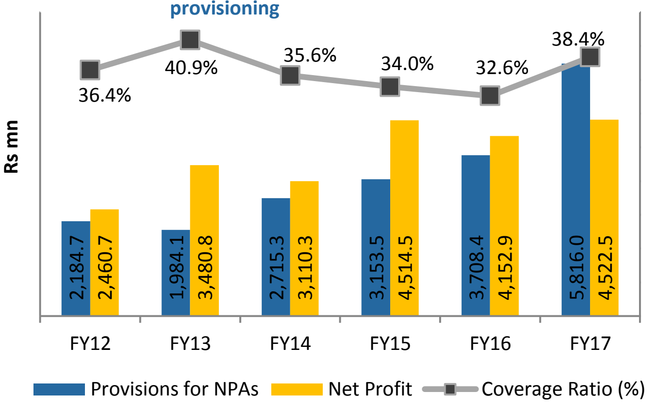
By FY17, GNPA ratio of KBL increased to 4.2% (3.4% in FY16) due to the higher slippage of Rs13,483.7 mn and thereby slippage ratio increased to 3.8% from 3.4% in the previous fiscal. Higher slippage was mainly due to the high corporate accounts (accounts of Rs50 mn or above as per Company Filings) consisting 37 clients with overall slippage of Rs10,640 mn (80% of the total slippage).

Increased exposure to stressed sectors during FY11-FY14 and RBI assets quality review under which it asked lenders to make provision, led to high slippage for KBL. After recovery and upgradation (R&U) of Rs4,891.7 mn, GNPAs of the bank stood at Rs15,815.9 mn. KBL has provided for Rs5,816 mn as provisions for NPAs leading to NNPA at Rs9,747.3 mn and coverage ratio (excl. technical write-off) rose to 38.3% in FY17 v/s 32.6% in FY16. Over FY15-FY17, provisioning for NPAs increased by a CAGR of 35.9%, despite this KBL's profit remained intact bolstered by strong growth in NII and other income.

Assets quality trend



KBL.s continued to witness profitabilty despite high provisioning



Source: Choice Broking, Company data

We drive comfort for assets quality improvement on the back of following factor:

- **Stressed assets problem likely to ease going forward**
- **Enhanced focus on retail segment and better rated corporates**
- **Improving economic conditions of India**

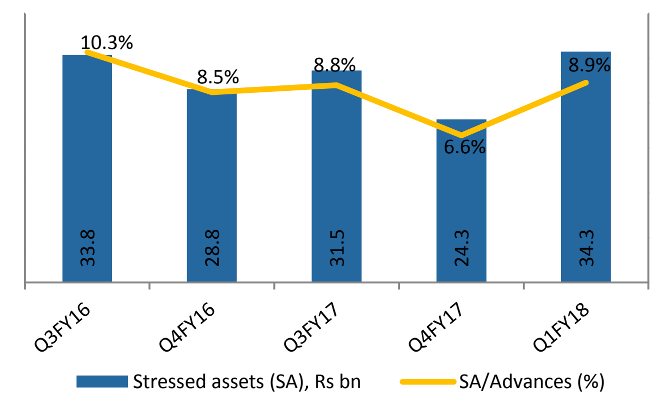
- **Stressed assets problem likely to ease going forward**

The bank's stressed assets stood at Rs34,330 mn or 9% of advances by Q1FY18 and it compromising GNPAs of Rs16,910 mn and watch list of Rs17,420 mn (watch list is under various recovery windows such as 5/25, SDR and S4A). Though, stressed assets remained higher, there is high probability of R&U in these accounts. Stressed assets accumulation is likely to reduce going forward on the back of two factors –

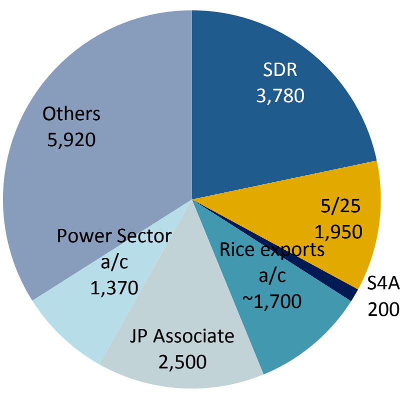
- **Accounts under the SMA2 list showing sign of recovery**
- **High likelihood of recovery and up-gradation in the substandard book**

The composition of SMA2 book is depicted below in the chart...

Stressed assets stood at 8.9% of advances by Q1FY18



SMA2 book stood at Rs17,420 mn by Q1FY18



Source: Choice Broking, Company data

SMA2 loan book includes 3 SDR accounts (a/c) under which 1 a/c of ~Rs490 mn was already in the IBC which is likely to slip in NPA during the current quarter and other 2 a/c of worth ~Rs3,780 mn of which the management is optimistic about resolving and seeing no concern. As on June 30'2017, the bank has seven account of ~Rs1,950 under 5/25 which is entirely standard assets and 1 SDR account of Rs200 mn.

Apart from this, big a/c in SMA2 included one rice exports account of worth Rs1,700 mn from north India from one aging client which has been with the bank over the last 20-25 years. Another big a/c in SMA2 list was to JP associate worth Rs2,500 mn and since the firm has sold plant to Ultratech Ltd. the management is confident that this account will become the stress free in coming quarter. Thereby, we believe that slippage from SMA2 list to be remained contained.

In terms of stressed assets, KBL is better placed in industry ...

Banking Industry	FY12	FY13	FY14	FY15	FY16	FY17
GNPA (%)	3.1%	3.6%	4.1%	4.5%	7.6%	9.8%
NNPA (%)	1.3%	1.9%	2.2%	2.4%	5.1%	5.6%
Stressed assets as % of loans	8.4%	9.8%	10.0%	10.9%	11.5%	13.1%

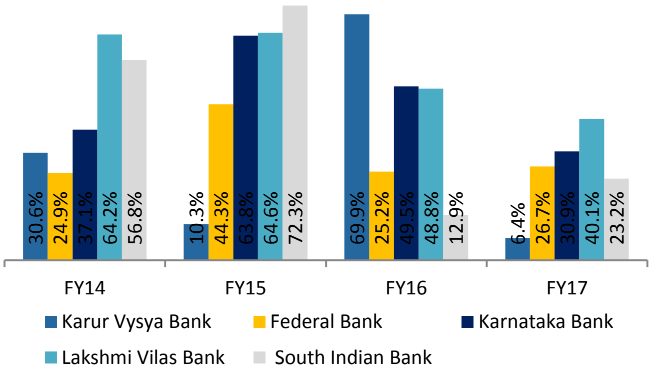
Particulars (Rs bn)	FY16	Q3FY17	FY17
GNPA of PSU banks	5,234.0	6,067.0	6,852.1
GNPA of private banks	519.2	833.0	902.0

Source: Choice Broking, Company data

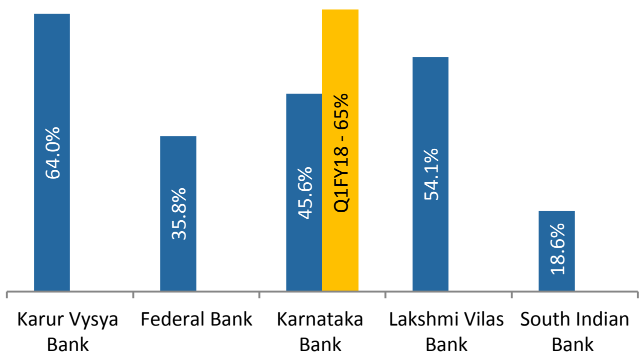
High proportion of substandard assets compared to peers

KBL,s GNPA ratio stood at 4.3% by Q1FY18 in line with the close peers (KVB-4.3%, LVB-3.8% and SIB-3.6%), however it mainly consist of substandard assets which accounted for around 65% of GNPAs by Q1FY18. Historically, bank's substandard assets remained higher than peers and given this remains the lowest risk category of GNPAs, there is also remained higher possibility of R&U. Furthermore, high proportion of substandard assets leads to KBL to make less provision (15% of provisions against substandard assets) and thus protecting the bank's profitability.

R&U/GNPA remaining better than peers



Substandard assets/ GNPA Mar'2017



Source: Choice Broking, Company data

As per the management, KBL's high portion of substandard assets was mainly due to the following reasons include **1)** higher probability of R&U of these assets given the track record of clients' businesses and **2)** assets are secured by valuable collateral.

Initiatives taking by KBL's management to contain slippage also providing comfort on assets quality front

Further reason to remain optimistic on assets quality outlook is to various initiatives that the management is taking to boost the KBL's risk management system.

In order to contain the slippage, the bank has constituted a separate credit monitoring department in all 12 regional branches. As per the strategy, loans up to Rs10 mn is being monitored by the credit monitoring department at regional office and above Rs10 mn by the credit monitoring department at head office. We are of the view that all these initiative would yield result in terms of reduction in slippage and accelerate the pace of R&U and thereby leading to improvement in assets quality in coming fiscals. KBL's has reported 1.35% of slippage during Q1FY18 which the management think a usual quarter of high slippage and expect that the slippage to remain below 1% in coming quarters.

- **Enhanced focus on retail segment and better rated corporates**

KBL is facing stress in corporate accounts consisting above Rs150 mn ticket size per account. Amidst the prevailing poor health of corporates as well as high risk of slippage from the corporate accounts, the bank took initiative to incline the loan book towards the less risky retail segment and reducing the significant exposure to the stressed sectors.

During the past two fiscals, the exposure to corporates reduced by (-)2.7% to 12.1% in FY17 from 14.8% in FY15 while the share of retail advances increased by the same amount to 47.5% by FY17 from 44.8% in FY15. The share of SME loan, which is considered less risky than large corporates, increased by 1.7% to 26.1% in FY17 v/s 24.4% in FY15. Furthermore, the exposure to stressed sectors like i.e. infrastructure, iron & steel and real estate has been reduced significantly over the last few two years.

Thereby reducing exposure to stressed sectors and risky corporate segment provide us comfort on slippage front. Over half or ~52% of KBL's advances are fully secured as on Q1FY18 and with the enhanced management's focus on retail and SME segment, the share of secured advance is likely to increase, easing the loan loss risks. The bank is adopting more cautious approach on new loan sanctions while retaining the growth, it is now focusing on AAA rated corporates and for retail and SME, the KBL's focus remain on those who have good track record, providing valuable collateral and where the bank's due diligence providing good opinion.

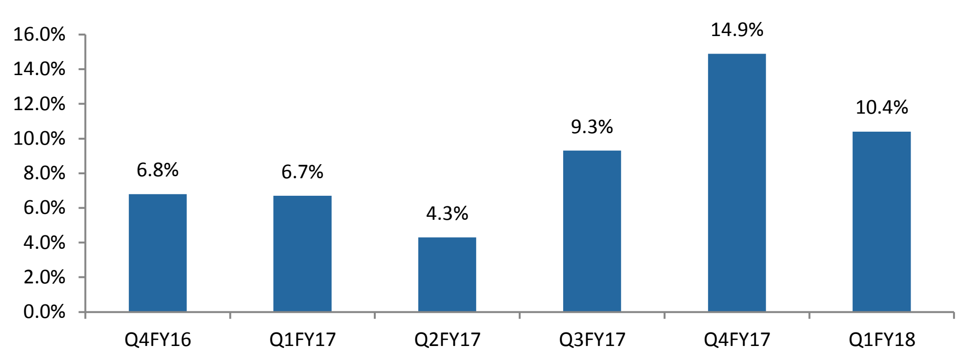
Sector-Wise Advances:	FY17			FY16			FY15			FY14		
Rs mn	**Advances**	**Advance Share (%)**	**GNPA (%)**	**Advances**	**Advance Share (%)**	**GNPA (%)**	**Advances**	**Advance Share (%)**	**GNPA (%)**	**Advances**	**Advance Share (%)**	**GNPA (%)**
Agriculture & allied	54,294.5	14.4%	3.2%	45,743.3	13.3%	2.3%	42,731.5	13.4%	2.0%	41,690.0	14.6%	2.0%
Textiles	14,288.4	3.8%	7.1%	18,283.2	5.3%	5.0%	14,934.6	4.7%	2.8%	14,238.2	5.0%	5.8%
Automobile	3,686.0	1.0%	40.9%	3,960.4	1.2%	0.0%	4,339.2	1.4%	0.0%	3,544.3	1.2%	0.0%
Iron & steel	3,509.1	0.9%	0.0%	5,410.3	1.6%	11.0%	6,180.9	1.9%	10.6%	6,372.5	2.2%	2.2%
Housing	62,794.5	16.7%	1.2%	57,746.8	16.8%	0.9%	52,155.5	16.3%	1.7%	41,752.0	14.6%	1.3%
Commr. real estate	4,426.9	1.2%	0.1%	4,325.0	1.3%	1.6%	15,415.9	4.8%	2.3%	13,638.2	4.8%	2.8%
Infrastructure	18,536.5	4.9%	8.0%	16,155.7	4.7%	11.5%	20,566.2	6.4%	1.8%	21,848.0	7.6%	3.0%
Services	80,767.7	21.5%	4.0%	68,855.2	20.1%	3.6%	57,297.9	17.9%	3.8%	44,636.3	15.6%	2.8%
Other personal loans	20,231.7	5.4%	1.6%	16,833.1	4.9%	4.1%	13,109.2	4.1%	2.0%	10,695.9	3.7%	1.6%
Others	113,317.1	30.1%	5.1%	105,422.0	30.8%	3.4%	93,222.4	29.1%	3.7%	87,824.1	30.7%	4.1%

Source: Choice Broking, Company data

- **Improving industry and economic scenario**

With the majority of stressed assets recognizing as NPAs, we are of the view that stressed assets which was 13.1% of advances by FY17, has peaked out and thus unlikely to increase as two-thirds of the overall stressed assets in the banking system has already been recognized by banks as NPAs as on FY17. Though the performance of agriculture and MSME sectors could witness some deterioration due the impact of GST and farm loan waivers, they are not unlikely to stress the bank's balance sheet like large corporates. The latest Crisil report highlights that the rating agency has seen improvement in large corporates' credit quality, improvement in capital structure and earning, further the prevailing interest scenario to improve the corporate repayment capacity.

Operating income Gr. (%), BSE 100 (ex-BFSI)



Source: Choice Broking, Company data, Ace equity

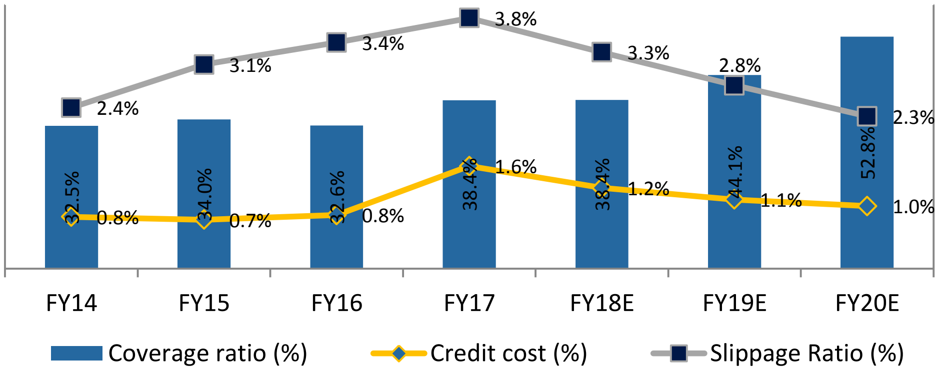
Karnataka Bank Ltd.

Banking

Factoring slippage ratio at 3% over FY18E-FY19E

All above rationale points towards the lower slippage in coming quarters, however we remain conservative due to the large size of SMA2 loan book and likelihood of increasing slippage from agriculture loan book because on farmer loan waiver in Karnataka state and thus assuming average slippage ratio at 3% over FY18E-FY19E. Given the strong track record of R&U and write-off of accounts which require one time settlement, GNPA ratio is expected to decline to 3.5% in FY19E from 4.2% in FY17.

Slippage ratio expecting at 3% over FY18E-FY19E



Source: Choice Broking, Company data

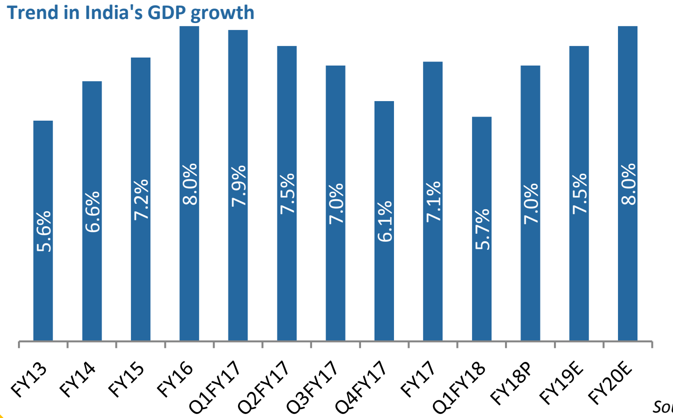
We also maintained our conservative stance over provisioning in the wake of low PCR of KBL among peers and thereby modelling average credit cost of 1.1% over FY18E-FY19E and thus our PCR (exc. Tech write-off) increased to 44.1 by FY19E v/s 38.4% by FY17.

NPA Trend	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Gross NPAs	8,359.4	9,442.1	11,804.0	15,815.9	16,629.9	18,168.0	18,475.9
Provisions for NPAs	2,979.0	3,206.6	3,849.3	6,068.6	6,391.7	8,014.4	9,759.5
Net NPA	5,380.4	6,235.5	7,954.7	9,747.3	10,238.2	10,153.7	8,716.4
GNPA(%)	2.9%	3.0%	3.4%	4.2%	3.8%	3.5%	3.1%
NNPA (%)	1.9%	2.0%	2.3%	2.6%	2.4%	2.1%	1.5%

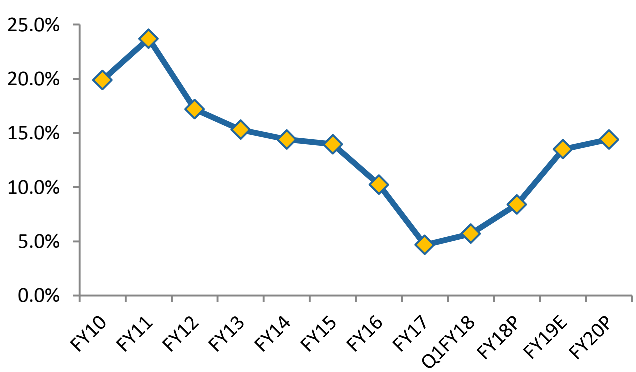
Source: Choice Broking, Company data

Industry advance growth likely to improve with economic recovery: Banking industry is highly correlated to the Indian economy as it get benefit from both sides of economy i.e. consumptions as well as investments. Strength of macro-economic fundamentals of the economy reflected from prevailing low interest and inflation scenario, contained CAD and fiscal deficit and stable exchange rate. Investment by private sector continued to remain lethargic as they are sitting at large installed capacity, thereby a strong emergence of demand is necessary to boost investments. Recent crop loan waivers announced by state governments, increase in minimum support prices for various crops and improving agriculture sector outlook are likely to boost the rural demand going forward. On the other hand, urban demand is likely to get support from prevailing low inflation & interest rate scenario and revision in the pay of states employees and pensioners under 7th pay commission.

Trend in India's GDP growth



Banking credit growth at historical (%)



Source: Choice Broking, Company data

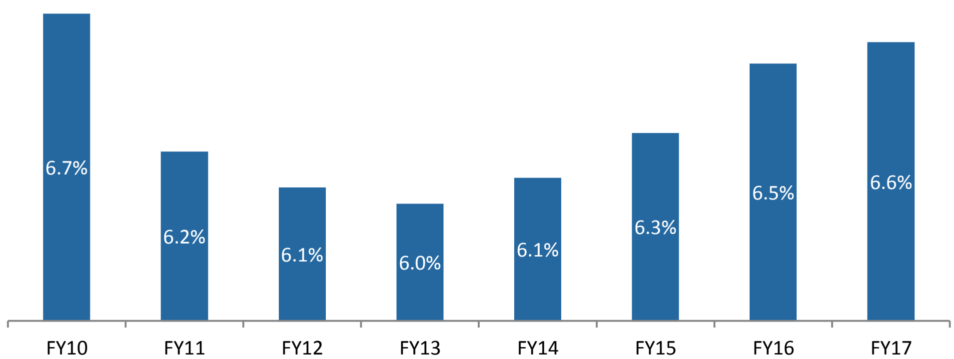
2) Business likely to grow at higher pace; factoring 15.5% CAGR in advances over FY17-F19E

- **Extensive presence in home state, increasing presence in high credit growth rich states under vision 2020**
- **Management strategies to increase the credit growth pace by focusing more on retail and MSME segments**

KBL is a regional bank with strong presence in Karnataka having around 62% of branches in the home state by Q1FY18. Karnataka is the one of the largest state and industrial & services industry hub driving the domestic GDP significantly. It is the second largest contributor to India GDP after Maharashtra and its net state value added (NSVA) grew at a CAGR of 7.2% during FY13-FY17, among the highest after Gujarat.

Owing to the large number of industries as well as services sector firms, credit off-take to the state remained higher and KBL is significantly leveraging this opportunities by allocating over 40% of the loan portfolio to home state. Karnataka's share to total banking credit stood at 6.6% by FY17 (behind Maharashtra at 29% and Tamilnadu at 9%) and is consistently increasing since FY11.

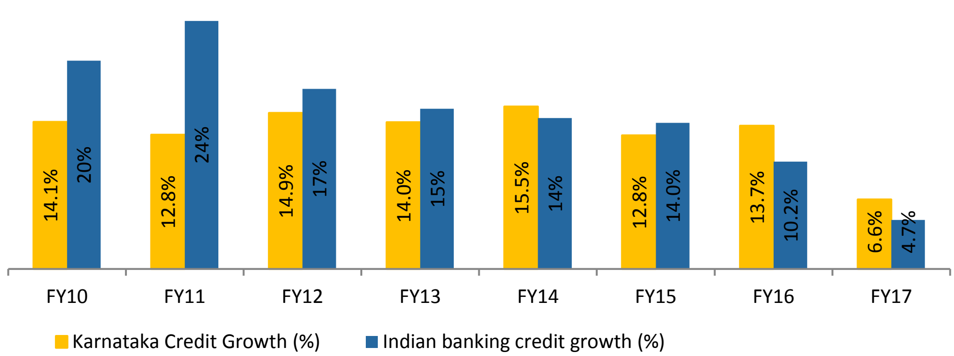
Karnataka witnessing sustained increase in market share in industry's credit



Source: Choice Broking, Company data

Furthermore, the Karnataka state witnessed loan growth on an average 2% higher than the industry growth over the last four fiscals. Though KBL's advance growth at 9.3% CAGR during FY14-FY17, remained lower than 11.0% of Karnataka state credit growth, this also represented ample opportunities to pick up growth and subsequently the bank is taking initiatives to boost credit growth. With the 6% of the total branches network, KBL extended around 16% of loan in FY17 to Maharashtra, which is the biggest state in India in terms of GDP contribution.

Karnataka's credit growth remaining higher than industry



Source: Choice Broking, Company data

Factoring 15.5% CAGR in advances over FY17-F19E

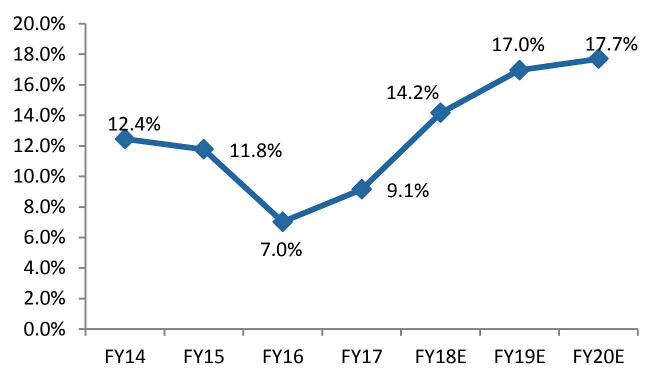
KBL has enhanced its focus on retail segment, this requires large branch network and strong customer interface. Further there is a direct linearity between branch expansion, CASA growth, core retail expansion and fee income growth. Thereby, the strategy to focus more on retail not only increases the low risk loan exposure but will also generate significant fee income. Under vision 2020, the bank planned to enhance the branches network to 1,000 (35 to added in FY18 and 100 branches each in FY19 and FY20). We are of the view that new branches, which are likely come in KBL,s non-penetrated states, will add new retail clients and SMEs located in that particular area. Amidst the increasing competition in lending space, we drive comfort from various initiatives taken by KBL to enhance its competiveness…..

• The bank has strengthened its internal credit process system through installing **Lending Automation Process System (LAPS)** which would help the bank to improve its turnaround time for loan processing.

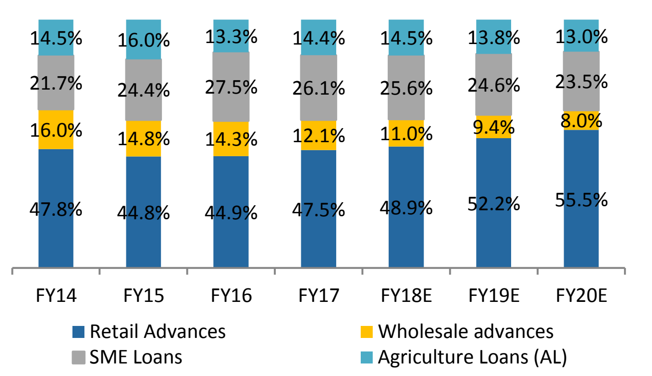
• Reducing share of PSBs as **six banks are already put under the Prompt Corrective Action (PCA)** and thus a number of good clients with clean record will come to premium bank like KBL having strong credit process system. RBI has initiated PCA on Central Bank of India, IDBI Bank, UCO Bank, Dena Bank, Indian Overseas Bank and Bank of Maharashtra .

• **Competitive MCLR rate** as KBL 1Y MCLR at 8.85% lower than close peers (One year MCLR of Peers at SIB-9.0%, Federal Bank -8.9%, KVB-9.0%, LVB-9.4%). High share of low cost deposits and low borrowing helps bank to maintain competitive lending rate compare to peers.

Factoring 15.5% CAGR in credit over FY17-FY19E



High yeilding retail advance share to increase



Source: Choice Broking, Company data
Advances break-up as per company's filing in PPT

KBL witnessing credit growth in retail, corporates and SME

The management is confident of driving growth in all three segments i.e. retail, corporate & SME.

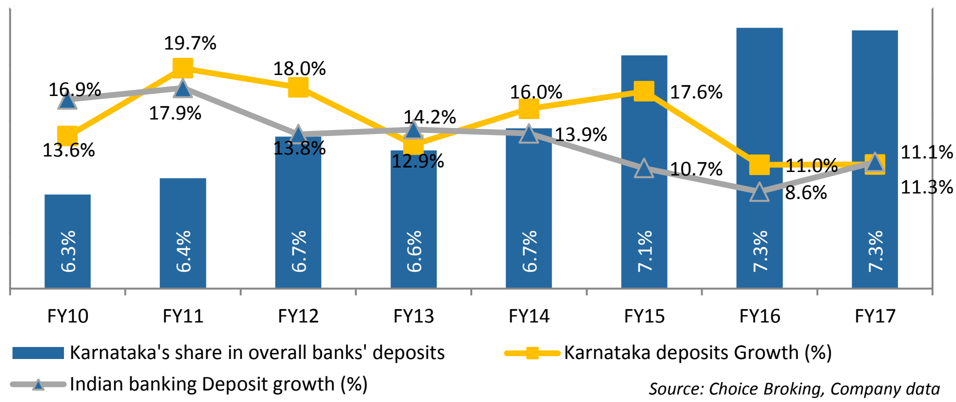
The bank strategized to keep MCLR rate competitive in order to attract corporate clients and is implementing quick & quality decision making and client specific product offering approach to boost the SME credit growth. While in the retail front, KBL is witnessing strong growth in housing and other personal loans.

We expect a strong growth in retail advances after considering the factor like improving economic condition, initiatives taken by KBL to attract retail customers, include more emphasizes on mobile banking and increasing liability franchise (distribution network) and government's 'Housing for All' initiatives. We are expecting a CAGR of 15.5% over FY17-FY19E in advances driven mainly by retail and SME segments.

CASA share likely to cross 30% in FY19E

On the back well distributed presence in the home state, KBL's deposit share in Karnataka is on upsurge rising to 7.3% in FY17 from 6.3% in FY10. During the past three fiscals, KBL's deposits growth remained at 11.8% lower than state's CAGR at 13.2% growth and industry growth rate at a CAGR of 10.2%. However, the steadily incremental increase in share reflecting the bank ability to attract a large number of retail clients.

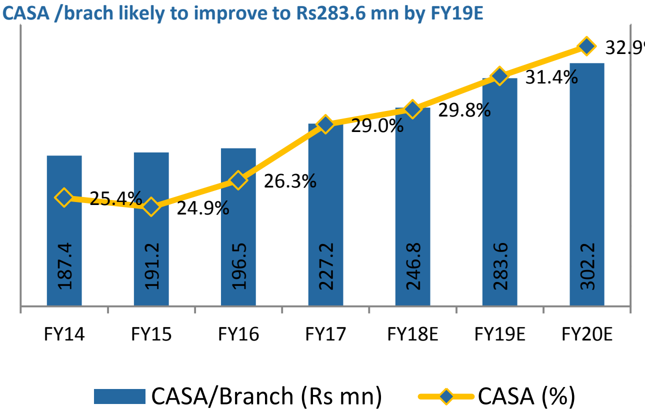
Deposits share steadily rising in home state



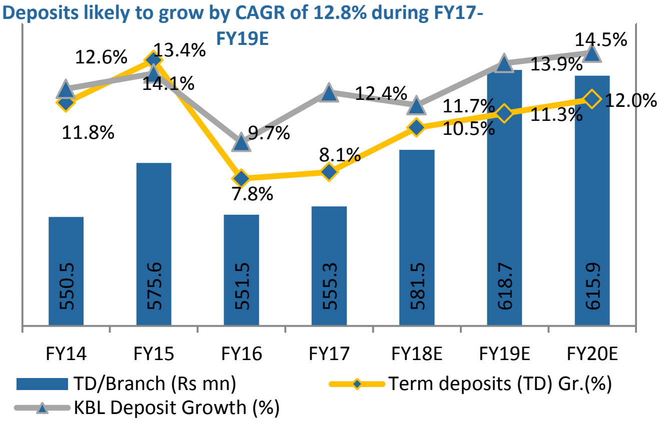
Source: Choice Broking, Company data

Over the last two fiscals, KBL's CASA deposit was increased by 16.9% CAGR against 11.8% growth in the overall deposits and thereby yielding result in terms of cost of deposits which declined to 6.7% in FY17 from 7.9% in FY15. With the increase in digitalization, the footfall in branches has reduced but we believe that branch banking model is still applicable in India as one can't expect to attract customers without opening a branch in a particular area. Given the factors like 1) low financial penetration in economy 2) higher saving rate and 3) demographic dividend with 65% of population <35 years and increased focus on digitalization, we believe that KBL with strong liability franchise can significantly accumulate deposits. CASA is expected to grow at a CAGR of 17.4% during FY17-FY19E higher than 12.8% growth in the overall deposits leading to increase in the CASA share to 31.4% by FY19E.

CASA /brach likely to improve to Rs283.6 mn by FY19E



Deposits likely to grow by CAGR of 12.8% during FY17-FY19E



Source: Choice Broking, Company data

3) Margins expecting to increase going forward

KBL's net interest margin (NIM) revolved around 2.5-2.7% over the last three years remaining lower than its close peers. However, this was despite the high CASA and yielding retail advances share clearly indicating that it was due to the 1) high cost of deposits and 2)low credit to deposits (C/D) ratio.

Particulars	FY15	FY16	FY17	Q1FY18	FY15	FY16	FY17	Q1FY18	FY15	FY16	FY17	Q1FY18	DR (%) (<1 cr)	
	NIM				C/D (%)				CASA(%)				IY	1-3Y
City Union Bank Ltd.	3.1%	3.2%	3.6%	4.5%	81.6%	77.5%	79.1%	79.1%	19.2%	20.4%	23.4%	23.3%	7.10%	6.85%
DCB Bank Ltd.	3.4%	3.4%	3.5%	4.2%	101.4%	86.6%	82.0%	82.0%	23.4%	23.4%	24.3%	27.0%	6.65%	7.00%
Karur Vysya Bank Ltd.	2.9%	3.2%	3.5%	3.8%	82.5%	78.0%	76.2%	76.2%	22.0%	23.3%	27.7%	29.2%	6.75%	7.00%
The Federal Bank Ltd.	3.1%	2.8%	2.8%	3.1%	85.9%	73.4%	75.1%	75.1%	30.8%	32.9%	32.8%	33.4%	6.50%	6.50%
The Karnataka Bank Ltd.	2.4%	2.5%	2.5%	2.6%	78.1%	67.1%	65.2%	68.4%	24.9%	26.3%	29.0%	28.9%	6.70%	6.50%
The Lakshmi Vilas Bank Ltd.	2.2%	2.3%	2.3%	2.7%	88.0%	77.2%	77.7%	77.7%	16.7%	17.4%	19.1%	19.4%	6.75%	7.00%
The South Indian Bank Ltd.	2.5%	2.6%	2.4%	2.8%	78.7%	73.7%	70.2%	70.2%	20.6%	22.4%	23.8%	25.2%	6.75%	6.50%

Source: Choice Broking, Company data

Thereby, the improvement in cost of deposit and C/D ratio is crucial to revive the NIM:

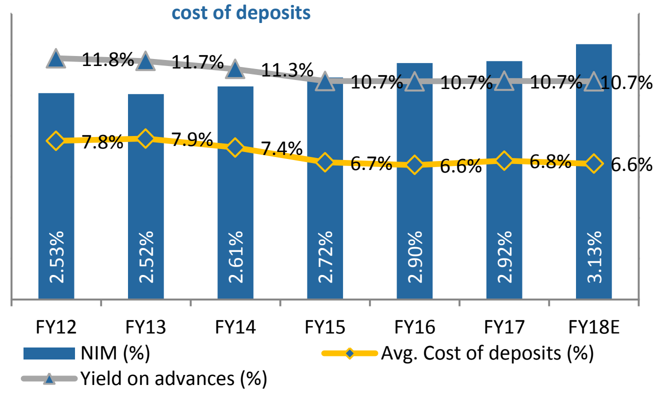
KBL's maintained higher rate of deposits in past compared to peers which adversely impacted the NIM through increasing the cost of deposits. Average cost of deposits during FY14-FY16 remained at 7.7% higher than peers, while the CASA deposits remained above 25% higher than peers during the same period. Increased management focus on improving margin and considering high growth in deposits, KBL reduced its deposits rate recently and now 2-3Y deposits rate stood in line or lower than its peers.

In Aug'2017, KBL has cut interest rate on Rs50 Lakh-1 cr of saving deposits to 3.5% from 4% and for the saving balance below Rs1 Lakh to 3% from 4% earlier. Increasing share of CASA and competitive deposits rate are expected to provide boost to margins.

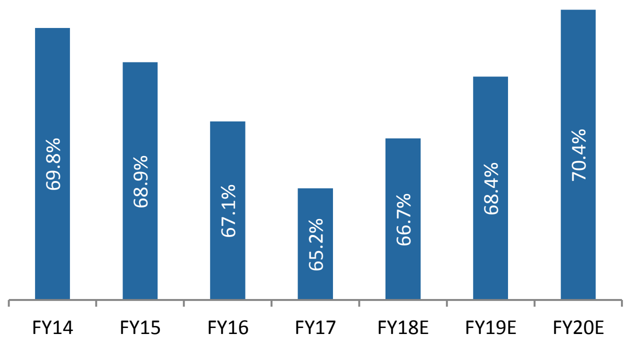
On assets-liability mismatch front, KBL has 42% of exposure to loans with 1-3 year tenure, which was mainly funded by deposits having 46% of total with the same maturity thereby reducing the dependence of borrowing. As the bank maintains ALM adequately, it is dependence on borrowing remains less compared to peers.

Over the last three fiscals, KBL's C/D ratio remained lower than peers and it can be attributed to management cautious stance on credit growth or can be due to lack of good strategy to boost credit growth because during the same period bank's credit growth remained 2% lower than the Karnataka's credit growth. Since the bank has reduced its deposits rate significantly and enhanced focus on credit growth, C/D ratio is expected to increase to 70% in the coming years.

NIM to improve to 2.9% by FY19E mainly driven by low cost of deposits



C/D ratio to improve to 68.4% by FY19E on the back of increasing focus on credit growth



Source: Choice Broking, Company data

4) C/I ratio likely to improve driven by improvement in operating efficiencies

Despite the 24.6% increase in total income, cost-to-income (C/I) ratio of KBL increased by 300 bps to 56.7% in FY17 mainly due to the higher increase in employee expenses. Going forward C/I ratio likely to improve due to the following factors…

- **Normalization in employee expenses; likely improvement in cost efficiencies driven by higher usages of digitalization**

- **Strong total income growth bolstered by high other income driven by improvement in fee income**

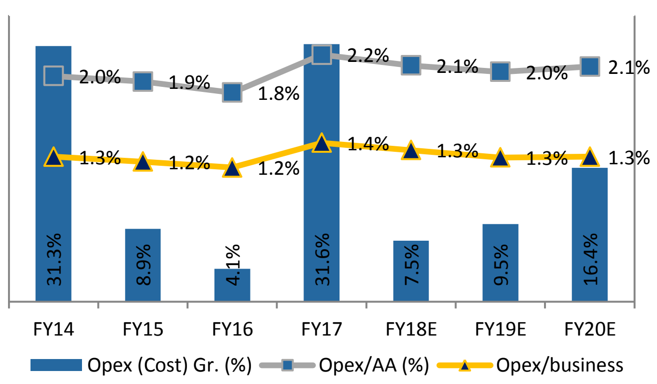
By the end of FY17, KBL's C/I ratio remain at higher side among peers, however it was mainly driven by higher employee expenses, further this expenses was due to some additional terminal benefits (mainly pension related) rather than fixed cost as KBL only added 190 employees during FY17 v/s over 410 in FY16.

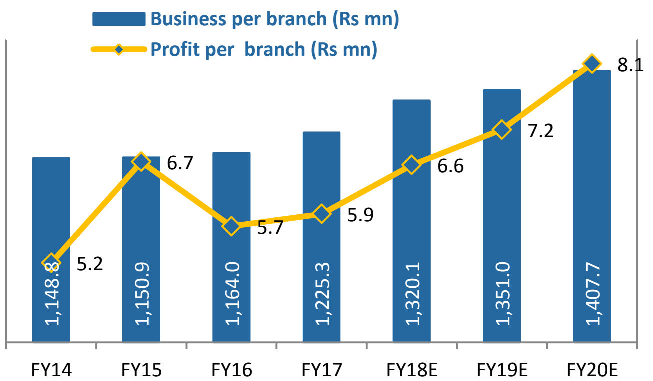
Companies (Rs mn)	C/I ratio			Business/ Branch (Rs mn)		
	FY15	FY16	FY17	FY15	FY16	FY17
City Union Bank Ltd.	42.8%	40.1%	40.9%	842	918	981
DCB Bank Ltd.	58.8%	58.5%	60.0%	1350	1406	1540
Karur Vysya Bank Ltd.	53.9%	47.6%	45.0%	1270	1337	1331
The Federal Bank Ltd.	50.1%	56.7%	53.4%	890	1096	1366
The Karnataka Bank Ltd.	53.9%	53.7%	56.7%	1071	1164	1225
The Lakshmi Vilas Bank Ltd.	54.6%	57.1%	50.7%	873	982	1131
The South Indian Bank Ltd.	52.7%	56.6%	49.2%	1033	1161	1324

Source: Choice Broking, Company data

Though the KBL has adopted the aggressive branch expansion strategy under the VISION 2020, we think that higher usage of digitalization leading to operating efficiency, sustained increase in business per branch and expected strong growth in total income to offset the increase in cost related to enhancing the distribution network. Considering the possible increase in expenditures due to aggressive strategy of increasing the liability franchise, we arrived at average cost-to-average assets (Opex/AA) at 2.1% over FY17-FY19E compared to same at 2.1% during FY15-FY17.

Cost/AA lilely to over 2% during FY17-FY19E





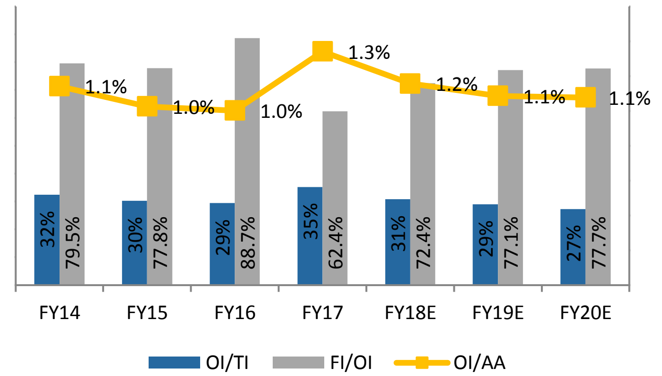
Source: Choice Broking, Company data

Other income to be driven by high fee income; expecting 12.5% CAGR in fee income during FY17-FY19E

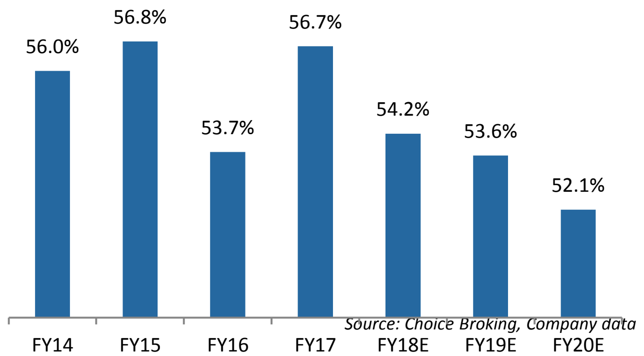
Other income (OI) grew by 49.1% in FY17 compared to meager average growth of 3.7% during the last two fiscals and fee income (FI) growth of 5.0% in FY17. However, this was mainly driven by high trading profit as KBL invested a handsome amount in the government securities in the wake of increasing deposits in the bank after government demonetization move (investment/deposits ratio increased to 35.6% in FY17 from 32.2% in FY16).

We are expecting a CAGR of 12.5% during FY17-FY19E after considering few factors i..e. **1)** KBL's focus for increasing presence of retail & SME clients on assets side and low cost deposits in liability side **2)** expected high growth in credit leading to high loan processing fee **3)** increasing number of clients for selling the third party products and **4)** expected revision in fee structure.

Higher fee income to drive other income



C/I ratio to trend lower going forward



Source: Choice Broking, Company data

5) Well capitalized; able to fund assets growth in coming future

KBL with a CAR(%)at 13.0% and Tier I at 11.9% by Q1FY18, is among the well capitalized banks which is crucial to fund the advances growth especially when the banks are facing impact on profitability. During the FY17, the bank has allotted 94.1 mn shares as right issue at a premium of Rs60 per share and capital base was strengthen by Rs6,598.6 mn.

Capital adequacy (%) Basel III	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Tier I (Rs mn)	30522.0	33691.3	36,751.8	47,494.2	52,689.8	57,950.3	66,557.3
Tier II (Rs mn)	6,993.4	6,040.5	5,100.6	4,227.4	5,415.5	7,236.3	7,999.2
Total capital (Rs mn)	37,515.4	39,731.8	41,852.4	51,721.6	58,105.3	65,186.6	74,556.5
Total risk weighted assets (Rs mn)	282,470.9	320,199.1	347,873.4	389,022.5	435,032.5	505,362.6	597,866.1
Tier-1 capital adequacy ratio	10.8%	10.5%	10.6%	12.2%	12.1%	11.5%	11.1%
Tier-2 capital adequacy ratio	2.5%	1.9%	1.5%	1.1%	1.2%	1.4%	1.3%
Total capital adequacy ratio (Basel III)	13.3%	12.4%	12.0%	13.3%	13.4%	12.9%	12.5%

Source: Choice Broking, Company data

Capital position of KBL is likely to remain stable on the following factors –

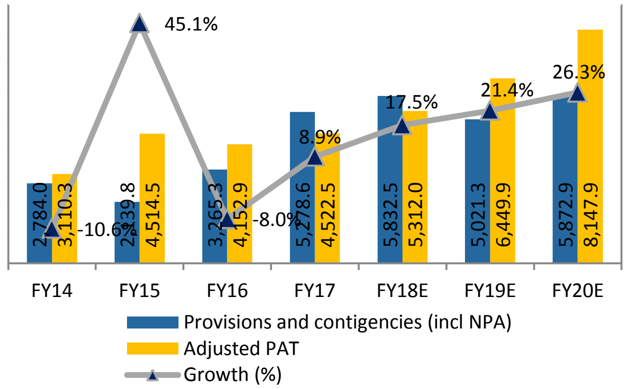
- The bank is targeting the AAA rated corporates
- Emphasizing only those SME who have good track record of performance and providing valuable collateral
- Increasing exposure to retail which is low risk segment

Financial Analysis:

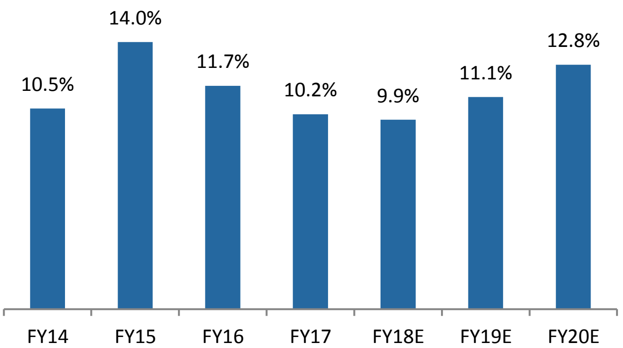
PAT likely to grow 19.4% CAGR during FY17-FY19E

NII grew by a CAGR of 12.9% during FY15-FY17 as interest income grew by 5.1% higher from interest expenses which grew by 2.3% during the same period. Despite 57.1% CAGR in P&C, net profit of the bank remained intact at Rs4,522.5 mn with flat growth. While NII is expected to increase by a CAGR of 17% during FY17-FY19E, net profit of the bank is likely to grow at 19.4% to Rs6,449.9 mn supported by the low P&C on the back of improving assets quality outlook. RoE is expected to improve to 11.1% by FY19E from 10.2% in FY17, however if we adjust this with revaluation of land & building proceed, it would improve to 11.6%.

Low provisioning to boost profitability



RoE likely to improve to 11.1% by FY19E



Source: Choice Broking, Company data

Key financials assumptions	FY17	FY18E	FY19E	FY20E
KBL				
Advances Gr. (%)	9.1%	14.2%	17.0%	17.7%
Deposits Gr. (%)	12.4%	11.7%	13.9%	14.5%
Branches	765	800	900	1,000
Other Income Gr. (%)	49.1%	-3.1%	5.7%	12.9%
No. of employees	6,010.3	6,626.2	6,843.2	8,018.7
C/I ratio (%)	56.7%	54.2%	53.6%	52.1%
C/D ratio (%)	65.2%	66.7%	68.4%	70.4%
GNPA (%)	4.2%	3.8%	3.5%	3.1%
PCR (excluding techn. Write-off)	38.4%	38.4%	44.1%	52.8%
Investment/Assets (%)	31.5%	30.3%	29.2%	28.1%
Banking Industry				
Banks credit Gr. (%)	4.7%	8.4%	13.5%	14.4%
Economy				
GDP Gr. (%)	7.1%	7.0%	7.5%	8.0%
Inflation rate (%)	4.5%	4.5%	5.0%	5.0%
Policy repo rate (%)	6.25%	6.25%	6.50%	6.50%
CRR (%)	4%	4%	4%	4%
10 Y (2025) GS rate (avg.)	7.3%	7.2%	7.5%	7.5%

Source: Choice Broking, Company data

Risks to our Assumptions:

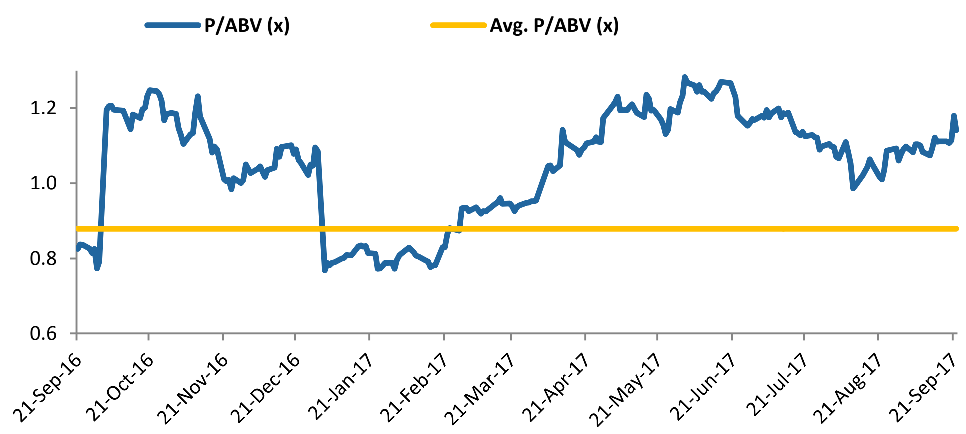
- Slow recovery in Indian economy
- Rising competition in banking industry
- Low credit growth compared to peers
- Risk of slippage to GNPAs from SMA2 list
- Risk of high provisioning due to slippage from assets to doubtful categories from substandard category
- Risk of increasing of opex due to aggressive expansion in liability franchise in coming fiscals

Valuation: We are positive on KBL's business outlook and our optimism are driven by following factors including 1) improving assets quality outlook 2) high likelihood of strong credit growth 3) enhanced focus on retail, SME clients and fee income growth 4) well capitalized, enabling the bank to fund assets growth and 5) improving operating efficiencies. Though KBL's credit growth remained lower than peers, it has managed RoE in double digit, CASA and NIM in line with peers supported by high share of CASA. Under the VISION 2020, the management has set target to double the bank's business size to Rs1,800 bn by FY20 (Rs937.4 bn in FY17) with C/D ratio at 80% and to become the preferred banker of at least 1% of Indian population. Further, KBL's focus to remain on increasing low cost deposits (CASA deposits), improving C/D ratio and shifting the business mix toward the retail and MSME segments which would help to increase the margin and return ration in coming fiscals. Accordingly, it has planned to enhance the branch network to 1,000 and ATM to 2,500. KBL has set up credit monitoring cell and is extending loans to high rated corporates and valuable collateral backed SME loans along with increasing exposure to less risky high yielding retail loans which we think to boost business growth while mitigating risk involved in lending. Besides the strong growth in business, we believe that fee based income, also backed by established digital banking platform, to provide support to income which in turn will help to tilt C/I towards 50%.

To value the stock we consider two factors which includes 1) improving business outlook which we have discussed in report and 2) high probability of increasing the trading multiple of KBL's stock. Any business which shows sustained improvement in key performance parameters (fundamental strength) tend to shift to higher multiple. Historically, KBL's stock has traded at a P/ABV (x) of 0.5-1.3 which is at deep discount to peers making a strong case of multiple re-rating. Considering all these view, we value the stock at P/ABV multiple of 1.2(x) to FY19E adjusted book value of Rs177.7 per share and arrived at potential price of Rs213 per share.

At a time when it became difficult to find fundamental strong stock at cheap valuation, KBL is among the few stocks which is catching or will soon catch the investors' eyes. Therefore, we are seeing strong potential in the stock at current level.

P/ABV Valuation	FY16	FY17	FY18E	FY19E	FY20E
Adjusted BVPS (Rs)	153.6	147.5	160.0	177.7	204.7
Valuation Parameters					
P/ABV (x)	1.2				



Companies (Rs)	CMP	6M R%	12M R%	M Cap (Rs mn)	FV (Rs/s)	P/ ABV	NNPA (%)	CAR (%)	RoE (%)	RoA (%)	C/I (%)	C/D (%)	CASA (%)	NIM (%)	BS (Rs bn)	BS/B (Rs mn)
City Union Bank	150	15.5%	26.2%	90,160.5	1	2.5	1.8%	15.9%	13.0%	1.5%	40%	79.1%	23%	4.5%	539.5	980.9
DCB Bank	177	5.0%	43.8%	54,434.6	10	2.4	0.9%	15.3%	9.2%	0.9%	59%	82.0%	27%	4.2%	351.1	1,210.6
Karur Vysya Bank	143	31.3%	52.6%	87,129.9	2	1.8	2.9%	11.7%	10.0%	1.0%	48%	76.2%	29%	3.8%	946.1	1,315.8
Federal Bank	110	22.6%	52.5%	213,653.0	2	2.7	1.4%	15.3%	9.6%	0.8%	52%	75.1%	33%	3.1%	1,710.0	1,365.8
Karnataka Bank	140	1.6%	15.2%	39,566.1	10	0.9	3.2%	13.0%	8.0%	0.7%	57%	68.4%	29%	2.7%	947.1	1,231.6
Lakshmi Vilas Bank	147	-11.6%	-6.2%	28,195.6	10	1.3	2.8%	11.7%	9.5%	0.7%	49%	77.7%	19%	2.7%	542.8	904.7
South Indian Bank	27.9	38.1%	38.0%	50,314.9	1	1.5	2.5%	12.1%	6.9%	0.5%	47%	70.2%	25%	2.8%	1,125.1	1,322.1

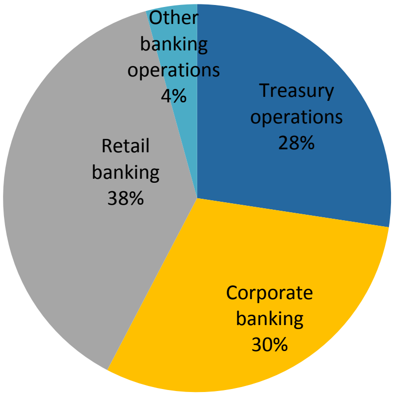
Source: Choice Broking, Company data

Karnataka Bank Ltd.

Banking

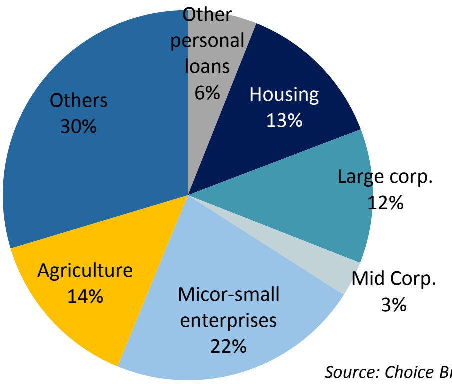
Company Information: Karnataka Bank Ltd. (KBL), is a private sector bank incorporated in 1924 in Mangaluru. With the 769 branches and 1,398 ATMs spreading across India and employee strength of 7,982, the bank provides entire spectrum of the financial services to customer segments covering large and mid-corporates, MSME, agriculture and retail businesses. As the name suggests, KBL is a Karnataka based bank driving major business from the home state on the back of strong presence of 473 branches. Given 62% of branches in home state, the bank enjoys a respectable ~3% market share in Karnataka. Besides, KBL has 6% branches in the Maharashtra state. KBL attained a balance sheet size ofRs641 bn in FY17 with a five year CAGR of 11.5% in total assets, 11.2% in business size. KBL is professionally managed company with promoter and promoter group holding 0% of shareholding.

Segment revenue by FY17



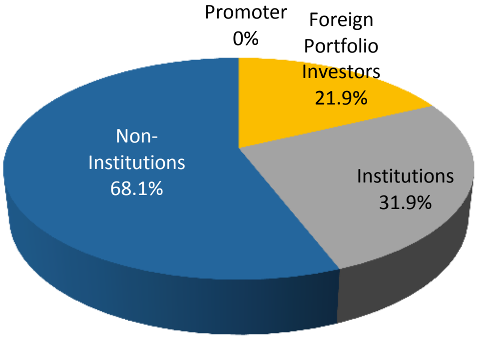
Top shareholders holding more than 1% of share capital	Q1FY18
Mutual Funds	2.97%
Alternate Investment Funds	0.14%
Lsv Emerging Markets Equity Fund Lp	1.39%
Acadian Emerging Markets Small Cap Equity Fund Llc	1.15%
Government Pension Fund Global	1.12%
State Street Active Emerging Markets Small Cap Non-Lending Qib Common Trust Fund	1.03%
Life Insurance Corporation Of India	5.28%

Loan book, sector wise exposure (Q1FY18)



Source: Choice Broking, Company data

Shareholding pattern (Q1FY18)



Source: Choice Broking, Company data

Date	Recent Events
Sept 24,2017	Board has given principle approval for implementing transformation initiatives by engaging a consultant
Sept 18,2017	Karnataka Bank opens its 772nd branch at Makanahalli
Sept 4,2017	Karnataka Bank reduces One Year MCLR by 5 bps
Sept 2,2017	Karnataka Bank bags IDRBT Banking Technology Excellence Awards 2016-17
Aug 16,2017	Karnataka Bank ventures into Social Media Presence
Aug 2,2017	Karnataka Bank rationalizes savings bank interest rate
Aug 1,2017	Proceedings of Annual General Meeting held on July 17, 2017 along with a copy of minutes
Jul 21,2017	Karnataka Bank aims export credit target of Rs25,000 mn
Jul 20,2017	Formation of Investor Relation Cell for dissemination of corporate information of the Bank
Jul 20,2017	Bank launches "Met Loan and Life Suraksha" product for its customers with association with PNB Met Life
Jul 19,2017	Karnataka Bank aims at Rs68,000 mn of farm credit during FY18
Jul 15,2017	Bank reported its Q1FY18 result

Source: Choice Broking, Company data

Five Quarters at a Glance

Particulars (Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	YoY	QoQ
Interest Earned	12,606.0	13,063.7	13,239.3	12,945.0	13,305.4	5.5%	2.8%
Interest Expended	8,959.1	9,091.2	9,474.2	9,423.3	9,061.2	1.1%	-3.8%
NII	3,646.9	3,972.5	3,765.1	3,521.7	4,244.2	16.4%	20.5%
Operating Expenditures	2,771.3	3,542.0	3,382.4	3,345.9	3,321.1	19.8%	-0.7%
Pre- Prov Operating Profit	2,619.2	2,327.5	1,718.6	3,292.7	3,097.0	18.2%	-5.9%
Provisions and contigencies (incl NPA)	1,363.1	1,305.5	1,006.0	1,604.0	1,988.8	45.9%	24.0%
Other Income	1,743.6	1,897.0	1,335.9	3,116.9	2,173.9	24.7%	-30.3%
PBT	1,256.1	1,022.0	712.6	1,688.7	1,108.2	-11.8%	-34.4%
Tax	40.7	-216.2	27.4	305.0	-230.3	-665.8%	-175.5%
Net Profit	**1,215.4**	**1,238.2**	**685.2**	**1,383.7**	**1,338.5**	10.1%	-3.3%
Outstanding Shares	211.0	188.5	282.6	282.6	282.6	33.9%	0.0%
Dil. EPS	5.8	6.6	2.4	4.9	4.7	-17.8%	-3.3%
Balance Sheet items/ratios							
Deposits	515,010.0	530,960.0	635,950.0	567,330.0	562,270.0	9.2%	-0.9%
CA Deposits	32,548.6	33,609.8	41,336.8	36,233.1	36,941.1	13.5%	2.0%
SB Deposits	102,487.0	106,192.0	150,847.3	128,498.1	125,779.8	22.7%	-2.1%
CASA	135,035.6	139,801.8	192,184.1	164,731.2	162,720.9	20.5%	-1.2%
Advances	349,460.0	361,160.0	357,860.0	370,036.5	384,840.0	10.1%	4.0%
CD Ratio (%)	67.9%	68.0%	56.3%	65.2%	68.4%		
CASA Share (%)	**26.2%**	**26.3%**	**30.2%**	**29.0%**	**28.9%**		
CAR(%)	13.0%	11.2%	13.2%	13.3%	13.0%		
Tier 1 (%)	10.3%	9.8%	11.9%	12.2%	11.9%		
Profitabilitiy							
Cost of deposits (%)	6.95%	6.9%	7.6%	7.5%	7.0%	0.0%	-7.5%
NIM(%) reported	**2.55%**	**2.62%**	**2.54%**	**2.44%**	**2.64%**	3.5%	8.2%
Cost-Income Ratios (%)	51.4%	60.3%	66.3%	50.4%	51.7%	0.7%	2.7%
Tax Rate (%)	3.2%	-21.2%	3.8%	18.1%	-20.8%	-741.4%	-215.1%
Assets Quality				**215.90**	**1,094.10**		
Gross NPA	13,890.0	13,450.0	15,600.0	15,815.9	16,910.0	21.7%	6.9%
Net NPA	9,110.0	9,610.0	10,660.0	9,750.0	12,300.0	35.0%	26.2%
Gross NPA (%)	3.92%	3.68%	4.30%	4.21%	4.34%		
Net NPA (%)	**2.61%**	**2.7%**	**3.0%**	**2.6%**	**3.2%**		
Coverage Ratio(%)	34.4%	28.6%	31.7%	38.4%	27.3%		
RoA(%) (Annualized)	0.00%	0.00%	0.00%	0.0%	0.0%		
Slippages							
O/s Restructured book	17,590.0	16,580.0	16,160.0	13,650.0	11,400.0		
RA % of loan book	5.03%	4.6%	4.5%	3.7%	3.0%		
Gross slippages	3,370.0	2,330.0	2,670.0	5,110.0	4,980.0	47.8%	-2.5%
Recoveries+ Up gradations	1,280.0	2,780.0	510.0	4,900.0	3,890.0	203.9%	-20.6%
Write-offs	0.0	0.0	0.0	0.0	0.0		
Slippages (Net Addition to GNPAs)	2,090.0	-450.0	2,160.0	210.0	1,090.0	-47.8%	419.0%
Slippages (%)	1.0%	0.7%	0.8%	1.42%	1.35%		
Advances Break-Out							
Total Advances	349,460.0	361,160.0	357,860.0	370,036.5	384,840.0	10.1%	4.0%
Retail Advances	159,563.4	167,433.8	167,442.7	175,619.3	188,032.8	17.8%	7.1%
Corporate Credit	50,951.3	49,226.1	48,883.7	44,811.4	45,218.7	-11.3%	0.9%
SME	93,865.0	99,066.2	98,089.4	96,468.5	97,172.1	3.5%	0.7%
Agriculture Advances	45,080.3	45,433.9	43,444.2	53,137.2	54,416.4	20.7%	2.4%
Retail Advances Break-Out							
Other personal loans	20,268.7	21,416.8	21,543.2	22,165.2	23,244.3	14.7%	4.9%
Home Loans	44,730.9	45,253.3	47,165.9	48,992.8	50,683.4	13.3%	3.5%
Others	95,612.3	100,763.6	98,733.6	104,831.3	114,105.1	19.3%	8.8%
Network							
ATMs	1,300	1,319	1,334	1,380	1,398	7.5%	1.3%
Branches	733	736	738	765	769	4.9%	0.5%
Business per branch (Rs mn)	1,179.4	1,212.1	1,346.6	1,225.3	1,231.6	4.4%	0.5%

Source: Choice Broking, Company data

Source: Choice Broking, Company data

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Banking

Financial statements (Standalone, Rs mn)

Profit And Loss Statement

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Interest Income	49,922.1	51,854.0	58,167.4	67,829.0	77,987.1
Growth (%)	6.3%	3.9%	12.2%	16.6%	15.0%
Interest Expended	36,893.4	36,947.8	40,283.5	47,476.1	53,020.2
Growth (%)	4.5%	0.1%	9.0%	17.9%	11.7%
Net Interest Income	**13,028.7**	**14,906.2**	**17,883.8**	**20,352.9**	**24,966.8**
Net Interest Margin	2.6%	2.7%	2.9%	2.9%	3.1%
Other Income	5,428.6	8,093.4	7,957.5	8,291.9	9,360.6
% of Interest Income	10.9%	15.6%	13.7%	12.2%	12.0%
Total Income	18,457.3	22,999.6	25,841.4	28,644.8	34,327.4
Growth (%)	10.1%	24.6%	12.4%	10.8%	19.8%
Operating & Other expenses	9,912.0	13,041.6	14,012.6	15,354.4	17,872.8
Pre-Prov. Operating Profit	8,545.3	9,958.0	11,828.8	13,290.5	16,454.6
Provisions and contigencies (incl NPA)	3,265.3	5,278.6	5,832.5	5,021.3	5,872.9
P&C % of Advances	1.0%	1.4%	1.4%	1.0%	1.0%
Operating Profit before Tax	5,280.0	4,679.4	5,996.3	8,269.2	10,581.7
Growth (%)	-2.6%	-11.4%	28.1%	37.9%	28.0%
Pre-tax Margin %	28.6%	20.3%	23.2%	28.9%	30.8%
Tax	1,127.1	156.9	684.3	1,819.2	2,433.8
% of PBT	21.3%	3.4%	11.4%	22.0%	23.0%
Reported PAT	4,152.9	4,522.5	5,312.0	6,449.9	8,147.9
Net Profit Margin %	22.5%	19.7%	20.6%	22.5%	23.7%
Extrodinary Income	0.0	0.0	0.0	0.0	0.0
Adjusted PAT	**4,152.9**	**4,522.5**	**5,312.0**	**6,449.9**	**8,147.9**
Growth (%)	-8.0%	8.9%	17.5%	21.4%	26.3%

Balance Sheet

Particulars	FY16	FY17	FY18E	FY19E	FY20E
ASSETS					
Cash and balance with RBI	26,456.2	29,292.7	31,682.0	36,476.2	39,416.4
Balances with banks and money at call and short notice	3,993.0	3,447.6	5,117.6	3,848.7	3,058.6
Investments	162,566.5	202,197.3	216,190.6	237,095.0	260,429.6
Advances	339,024.5	370,036.5	422,414.5	494,045.1	581,478.0
Fixed assets	3,066.4	7,205.7	7,014.2	7,503.0	7,977.7
Other assets	29,896.7	29,085.7	32,148.9	32,400.0	33,553.3
TOTAL ASSETS	**565,003.3**	**641,265.5**	**714,567.8**	**811,368.0**	**925,913.5**
Capital	1,884.7	2,826.2	2,826.2	2,826.2	2,826.2
Reserves and Surplus	35,021.2	48,599.7	52,636.8	57,538.7	63,731.1
Deposits	504,882.1	567,331.1	633,650.8	721,826.8	826,249.6
Borrowings	10,514.8	8,326.2	10,228.9	11,402.3	12,273.0
Other liabilities and provisions	12,700.6	14,182.3	15,225.2	17,774.0	20,833.6
TOTAL CAPITAL AND LIABILITIES............	**565,003.3**	**641,265.5**	**714,567.8**	**811,368.0**	**925,913.5**

Financial Ratios

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Return / Profitability Ratios (%)					
Net interest margin	2.61%	2.72%	2.90%	2.92%	3.13%
Yield on advances	11.3%	10.7%	10.7%	10.7%	10.7%
Yield on investments	7.4%	7.1%	7.4%	7.8%	7.9%
EPS (Diluted) (Rs)	22.0	16.0	18.8	22.8	28.8
RoA	0.8%	0.7%	0.8%	0.8%	0.9%
RoE	11.7%	10.2%	9.9%	11.1%	12.8%
Avg. Cost of Deposits	7.4%	6.7%	6.6%	6.8%	6.6%
Operating ratios (%)					
Credit to Deposit	67.1%	65.2%	66.7%	68.4%	70.4%
Cost to income	53.7%	56.7%	54.2%	53.6%	52.1%
CASA	26.3%	29.0%	29.8%	31.4%	32.9%
Investment / Deposit	32.2%	35.6%	34.1%	32.8%	31.5%
Non interest income / Total income	29.4%	35.2%	30.8%	28.9%	27.3%
Capitalization Ratios (%)					
Equity / Assets	6.5%	8.0%	7.8%	7.4%	7.2%
Loans / Assets	60.0%	57.7%	59.1%	60.9%	62.8%
Investments / Assets	28.8%	31.5%	30.3%	29.2%	28.1%
Dividend payout	22.7%	25.0%	20.0%	20.0%	20.0%
Capital adequacy (%)					
Tier-1 capital adequacy ratio	10.6%	12.2%	12.1%	11.5%	11.1%
Tier-2 capital adequacy ratio	1.5%	1.1%	1.2%	1.4%	1.3%
Total capital adequacy ratio (Basel III)	12.0%	13.3%	13.4%	12.9%	12.5%
Asset Quality ratios (%)					
Gross NPA	3.4%	4.2%	3.8%	3.5%	3.1%
Net NPA	2.3%	2.6%	2.4%	2.1%	1.5%
Coverage Ratio	32.6%	38.4%	38.4%	44.1%	52.8%
Slippage Ratio	3.4%	3.8%	3.3%	2.8%	2.3%
Per Share Data (Rs)					
EPS (Diluted)	22.0	16.0	18.8	22.8	28.8
DPS	5.0	4.0	3.8	4.6	5.8
BVPS	195.8	182.0	196.2	213.6	235.5
Adjusted BVPS	153.6	147.5	160.0	177.7	204.7
Valuation ratios (x)					
P/E (x)	6.4	8.9	7.6	6.2	4.9
P/BV (x)	0.7	0.8	0.7	0.7	0.6
P/ABV (x)	0.9	1.0	0.9	0.8	0.7
Growth ratios (%)					
Advances	7.0%	9.1%	14.2%	17.0%	17.7%
Deposits	9.7%	12.4%	11.7%	13.9%	14.5%
Net interest income	11.5%	14.4%	20.0%	13.8%	22.7%
Interest income	6.3%	3.9%	12.2%	16.6%	15.0%
PAT	-8.0%	8.9%	17.5%	21.4%	26.3%
Business ratios					
Profit per branch (Rs mn)	5.7	5.9	6.6	7.2	8.1
Business per branch (Rs mn)	1,164.0	1,225.3	1,320.1	1,351.0	1,407.7

Source: Choice Broking, Company data

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Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral.

Disclaimer

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