

KARNATAKA BANK

BANKING

Q2FY19: Mixed operational performance

KBL reported a mixed performance for Q2FY19. NIM pressure, increase in slippages were disappointing, but strong loan growth with increasing share of high rate portfolio and reduction in stressed asset portfolio is comforting. NII growth was muted at 6% YoY even as loans grew 22%. Cost of funds at 5.94% was up 6bps QoQ (vs. 5bps QoQ rise in yield on advances). Growth in fee income was healthy at 20% YoY even as non-interest income growth lagged. Operating profit at Rs 356cr declined 3% YoY. Slippages moved up slightly to 2.95% from 2.26%QoQ. Credit costs have come down to 1.5% from 2.2% a year ago which aided PAT growth of 20% to Rs 112cr.

Outlook

Guidance of +20% growth in FY19 given by the management remains. We expect better revenue traction to come from improving retail proportion, which coupled with controlled opex will aid operating profit growth, but elevated credit cost on account of low PCR will cap earnings for the bank. We feel the stock is quoting at attractive valuations of 0.7x FY20 P/ABV and retain BUY on KBL with TP of Rs 136 (0.9x FY20 P/ABV).

BUY

Target Price: Rs136

CMP : Rs105
Potential Upside : 30%

MARKET DATA

No. of Shares : 28,27cr
FV (Rs) : 10
Market Cap : Rs 2,971.5 cr
52-week High / Low : Rs169 / Rs93
Avg. Daily vol. (6mth) : 6,69,841 shares
Bloomberg Code : KBL IN
Reuters Code : KBNK.BO
BSE Code : 532652
NSE Code : KTKBNK

Key Highlights

- Steady Asset quality:** Slippages were restricted to Rs 368cr (2.95% ann. vis-à-vis 2.26/3.64% QoQ/YoY) with GNPA's of 4.7%. Overall stressed book has now come down to 3.8% (from 4.1% in Q1FY19) as restructured book comes down. SMA-2 book has also been restricted to Rs 350cr. However credit costs is likely to remain high due to IL&FS exposure of Rs 160cr (standard) and low PCR. With a shift in loan mix towards high rated corporate portfolio and reduced stressed asset pool, we expect pace of new NPA accretion to moderate. We have built in credit costs of ~1.9% over FY19E.
- NIM under pressure:** Muted NII growth of 6% was on account of dip in NIMs even as loan growth remained strong at 22% led by the corporate segment. This, along with tepid non-interest income led to flattish top-line growth. Operating profitability was aided by lower opex and utilization of RBI's dispensation on amortization of MTM loss. We expect NIMs to sustain at ~2.9% over FY19-FY20E.

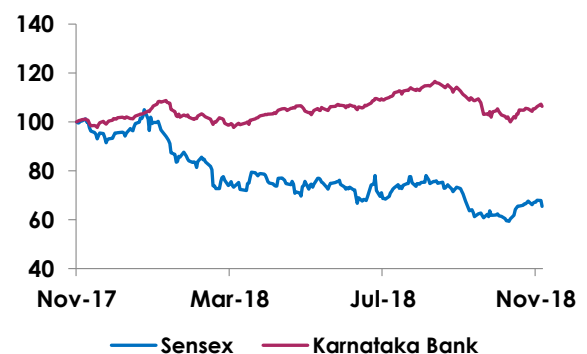
FINANCIAL SUMMARY

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)		
FY17	1,491	452	16.0	-27	182	6.9	0.80	2.64	147	1.0	10.2	0.7
FY18	1,858	326	11.5	-28.1	191	9.3	0.56	2.96	132	0.8	7.1	0.5
FY19E	2,155	446	15.8	37.1	202	6.8	0.53	2.75	138	0.8	11.2	0.8
FY20E	2,543	654	23.1	46.5	215	4.6	0.50	2.55	151	0.7	12.9	0.8

Source: Company; Axis Securities

Siji A Philip
siji.philip@axissecurities.in

PRICE PERFORMANCE



Key Highlights (Cont'd)

- **Yield compression:** Yield on advances fell to 9.34% from 10.15% in the same quarter last year. Management has stated that yield on advances will move up on account of interest-rate resets that will kick in over the rest of the year and lower the pressure on yields. Management indicated that about Rs100bn worth of loans started to re-price upward in the second fortnight of September due to MCLR resets worth 10bps-70bps and the full impact of the same will be felt in the coming quarter.
- **Loan growth robust:** Q2FY19 loan book grew 21.7% YoY and was led by strong traction in the segments of industrial segment (~22% YoY), home loans (~16.3% YoY) and LAP (~40% YoY). The new delivery models for retail and MSME segments has enhanced the business model and will aid in stronger growth and also improve their share in overall loans. As part of its retail strategy, the bank has tied up with more than 150 DSAs to shore up its retail / SME franchise. On the corporate front, 23% of the portfolio is towards multiple banking agreements; 3.3% of exposure is in form of consortium accounts. Exposure to NBFC sector is at Rs 8,300cr (16% of total loans) and is well within bank's internal limit of 18%. Apart from ILFS, the overall NBFC portfolio is servicing the loans on a timely basis and there is no single day default.
- **CASA softens:** CASA growth momentum continues, though lower than expectations, at 27.08% (vs. 27.35% in previous quarter). The management expects to achieve CASA ratio of 30% plus over next 2-3 years

Results Update

	Sep-18	Sep-17	% YoY	Jun-18	%QoQ	FY18	FY19E	FY20E
Interest Income	1,453	1,318	10.2	1,408	3.2	5,424	6,313	7,450
Interest Expenses	985	878	12.2	939	4.9	3,566	4,158	4,907
Net Interest Income	468	440	6.2	469	-0.2	1,858	2,155	2,543
Other Income	201	248	-18.8	209	-3.6	954	1,002	1,082
Total Income	669	688	-2.8	677	-1.3	2,812	3,157	3,625
Operating Expenses	313	322	-2.9	309	1.3	1,339	1,515	1,727
Employee	111	124	-10.7	111	0.3	525	604	688
Others	202	198	2.1	198	1.9	814	912	1,039
Operating Profits before provisions	356	366	-2.7	369	-3.4	1,473	1,642	1,898
Total Provisions	193	226	-14.5	222	-13.0	1,163	1,047	1,026
PBT	163	140	16.3	147	11.1	310	595	872
Taxes	51	47	9.3	16	2.1	-15	149	218
PAT	112	93	19.8	130.4	-14.2	326	446	654
EPS	4.0	3.3		4.6		11.5	15.8	23.1
Asset Quality								
GNPA Rs. Cr	2,372	1,716		2,297		2,376	2,643	2,895
NNPA Rs. Cr	1,498	1,247		1,396		1,401	1,546	1,678
GNPA %	4.7	4.1		4.7		4.9	4.7	4.4
NNPA %	3.0	3.0		2.9		3.0	2.8	2.6
Slippage Ratio %	2.9	3.6		2.3		5.0	3.0	2.8
Credit Cost %	1.5	2.2		1.9		2.5	1.9	1.6
Ratios %								
Cost to Income ratio	46.7	46.8		45.5		47.6	48.0	47.6
Loan/Deposit	78.2	72.7		76.1		75.2	76.4	76.4
CASA %	27.1	28.6		27.4		28.0	28.2	28.5
RoA %	0.8	0.7		0.9		0.5	0.8	0.8
RoE %	10.0	8.7		11.9		7.1	11.2	12.9
CAR (Basel III) %	11.3	12.5		11.6		12.0	11.5	11.0
Margins %								
Yield on Advances	9.3	10.2		9.3		9.7	9.9	10.0
Cost of Deposits	5.9	6.2		5.9		5.8	6.1	6.2
Quarterly NIMs	3.2	3.1		3.0		2.9	2.9	2.9
BV								
Adjusted Networth	4,085	4,043		4,178		3,727	3,896	4,287
Adj. BV	145	143		148		132	138	151
Balance sheet								
Capital	283	283		283		283	283	283
Net Worth	5,583	5,290		5,574		5,128	5,442	5,964
Deposits	63,885	56,558		62,725		62,871	73,559	86,065
Investments	16,036	16,734		15,861		15,444	16,217	18,649
Loans	49,970	41,127		47,731		47,251	56,229	65,788

Source: Company, Axis Securities Ltd

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, Siji A Philip, MBA (Finance), author/s and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We (Research Analyst) also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associate does not have any material conflict of interest. I/we have not served as director / officer, etc. in the subject company in the last 12-month period.

Any holding in stock – No

5. ASL has not received any compensation from the subject company in the past twelve months. ASL has not been engaged in market making activity for the subject company.
6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:
 - i. Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;
 - ii. Managed or co-managed public offering of the securities from the subject company of this research report and / or;
 - iii. Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report.

Term & Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

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

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Copyright in this document vests with Axis Securities Limited.

Axis Securities Limited, SEBI Single Reg. No.- NSE, BSE & MSEI – INZ000161633, ARN No. 64610, CDSL-IN-DP-CDSL-693-2013, SEBI-Research Analyst Reg. No. INH 000000297, SEBI Portfolio Manager Reg. No.- INP000000654, Main/Dealing off.- Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808, Reg. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkar Marg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, E-Mail ID: compliance.officer@axisdirect.in, Tel No: 022-42671582.