

KARNATAKA BANK

BANKING

Q3FY19: Asset quality stabilises

Loan growth momentum sustained at 17% YoY led by large corporate segment. However, NIM pressure due to interest income reversal restricted NII growth at 8% YoY. C-I moved up on higher staff costs consisting of largely one-offs. GNPA's improved to 4.45% sequentially from 4.66%. IL&FS exposure has been recognized as NPAs leading to slippage ratio of 3.1% ann. (PCR @ 15%). Lower credit cost aided better profitability of Rs 140cr during the quarter.

Outlook

Given the low stress (restructured/SR/SMA2) in book at 2.1% of advances, the bank is likely to witness improvement in assets quality front. Incremental stress has reduced and slippage have in controlled. While strong credit growth, declining stress in book and CASA target of 29% are positives, we expect credit cost to remain high due to higher provisions on IL&FS, restructured book under dispensation and lower coverage (>35%). We feel the stock is quoting at attractive valuations of ~0.7x FY20 P/ABV and retain BUY on KBL with TP of Rs 135 (0.75x FY20 P/ABV).

BUY

Target Price: Rs135

 CMP : Rs117
 Potential Upside : 15%

MARKET DATA

No. of Shares	: 28,27cr
FV (Rs)	: 10
Market Cap	: Rs 3,311.1 cr
52-week High / Low	: Rs149 / Rs93
Avg. Daily vol. (6mth)	: 5,82,412 shares
Bloomberg Code	: KBL IN
Reuters Code	: KBNK.BO
BSE Code	: 532652
NSE Code	: KTKBNK

Key Highlights

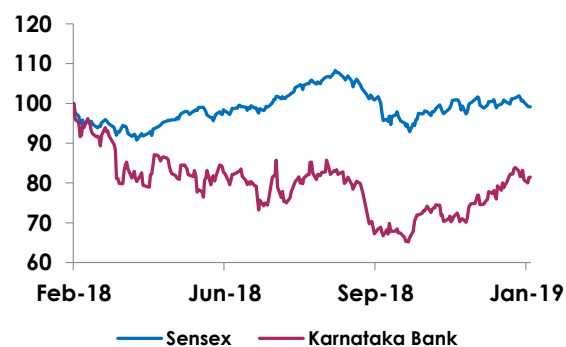
- Loan growth unabated:** Advances grew by 17.2/4% YoY/QoQ driven mainly by corporate credit. Retail credit grew by 9% YoY led by home loan growth (up 20% YoY). Of the total advances, agri portfolio is ~16% (Rs 720 cr) while NPA on this book is ~0.4%. NBFC exposure is ~15%. Management expects the slowdown in NBFCs a growth opportunity for the bank. MSME advances have grown 10.2% YoY, housing 22.1%, CRE (including mortgage) 13.8%. The bank is focusing on reducing consortium exposures, which stands at 3.18% (vs 3.81% a few years ago). We expect loan growth to be in 17-19% range over FY19-FY20E.
- Slight dip in CASA:** Deposits grew at 12.8% YoY, significantly lower than advances growth, despite this C/D at 79.8% remains at the comfortable level. CASA share stands at 26.7% (lowest in last 8 quarters). The management expects it to grow to 29-30% over the next 2-3 years. KBL added 13 branches in the quarter taking the total to 829.

FINANCIAL SUMMARY

Y/E Mar	NII (Rs Cr)	PAT (Rs Cr)	EPS (Rs)	Change (%)	BV (x)	P/E (%)	P/BV (%)	Net NPA (%)	ABV (Rs.)	P/ABV (x)	RoE (%)	RoA (%)
FY17	1,491	452	16.0	-27.0	182	6.9	0.80	2.64	147	1.0	10.2	0.7
FY18	1,858	326	11.5	-28.1	166	10.2	0.70	2.96	132	0.9	7.1	0.5
FY19E	2,087	518	18.3	59.1	205	6.4	0.57	2.75	168	0.7	10.4	0.7
FY20E	2,415	613	21.7	18.4	216	5.4	0.54	2.33	180	0.7	12.7	0.8

Source: Company; Axis Securities

PRICE PERFORMANCE


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Key Highlights (Cont'd)

- **Slippages in control:** Gross slippage was reported at Rs 407 cr (including IL&FS a/c slippage). GNPA reduced by 21 bps QoQ to 4.45%, while NNPA remained the same level. PCR remains on the lower side at 33.5% v/s 36.8% QoQ. IL&FS exposure which stands at Rs. 155 cr has been classified as NPA in the bank's books at a PCR of 15%. KBL's in the last 2 years has reduced its stress pipeline consisting of restructuring dispensations, net security receipts and watch-list (SMA2 book) from ~9.3% of loan book to 2.1% as of Q3FY19. We expect the G/NNPA likely to improve over FY18-FY20E to ~4.4/2.6%.
- **NII muted:** Interest income on IL&FS exposure (~Rs 6cr), MSME dispensation accounts (~Rs 10.7cr), MSME FITL accounts (~Rs 3cr), Loan waiver - related agri accounts (~Rs 10cr) amounted to a total non-recognition of about Rs 30cr of interest income. Consequently, NII growth was muted at 8% YoY at Rs 488cr.
- **Increase in C-I:** KBL has made an incremental provision of ~Rs 22cr due to wage revision and another incremental provision of ~Rs 2.9cr due to superannuation benefits resulting in higher staff costs of 49% YoY. We expect cost to income ratio (C-I) of 49.3% to normalize lower going forward.

Results Update

	Sep-18	Sep-17	% YoY	Jun-18	%QoQ	FY18	FY19E	FY20E
Interest Income	1,514	1,332	13.7	1,453	4.3	5,424	6,509	7,810
Interest Expenses	1026	881	16.5	985	4.2	3,566	4,422	5,395
Net Interest Income	488	451	8.1	468	4.3	1,858	2,087	2,415
Other Income	301	195	54.9	201	49.8	954	954	1,126
Total Income	789	646	22.2	669	18.0	2,812	3,041	3,542
Operating Expenses	389	324	20.0	313	24.4	1,339	1,431	1,741
Employee	181	121	48.9	111	63.1	525	520	701
Others	208	203	2.7	202	3.2	814	912	1,039
Operating Profits before provisions	400	322	24.4	356	12.4	1,473	1,610	1,801
Total Provisions	209	196	6.4	193	8.2	1,163	919	983
PBT	191	126	52.5	163	17.3	310	691	818
Taxes	51	38	33.7	51	0.0	-15	173	204
PAT	140	87	60.7	112	25.5	326	518	613
EPS	5.0	3.1		4.0		11.5	18.3	21.7
Asset Quality								
GNPA Rs. Cr	2,346	1,784		2,372		2,376	2,643	2,895
NNPA Rs. Cr	1,561	1,263		1,498		1,401	1,546	1,533
GNPA %	4.5	4.0		4.7		4.9	4.7	4.4
NNPA %	3.0	2.9		3.0		3.0	2.8	2.3
Slippage Ratio %	3.1	1.9		2.9		5.0	3.0	2.8
Credit Cost %	1.6	1.8		1.5		2.5	1.6	1.5
Ratios %								
Cost to Income ratio	49.3	50.2		46.7		47.6	47.1	49.2
Loan/Deposit	79.8	76.9		78.2		75.2	76.4	76.4
CASA %	26.7	28.2		27.1		28.0	28.2	28.5
RoA %	0.7	0.7		0.8		0.5	0.7	0.8
RoE %	9.9	8.0		10.0		7.1	10.4	12.7
CAR (Basel III) %	12.0	12.3		11.3		12.0	11.5	11.0
Margins %								
Yield on Advances	9.4	10.1		9.3		9.7	9.9	10.0
Cost of Deposits	6.0	6.2		5.9		5.8	6.1	6.2
Quarterly NIMs	3.4	3.0		3.2		2.9	2.9	2.9
BV								
BV	202	201		198		191	205	216
Adjusted Networth	4,162	4,420		4,085		3,727	3,968	4,463
Adj. BV	147	156		145		132	168	180
Balance sheet								
Capital	283	283		283		283	283	283
Net Worth	5,723	5,683		5,583		5,128	5,514	5,996
Deposits	65,141	57,771		63,885		62,871	73,559	86,065
Investments	15,700	15,695		16,036		15,444	16,217	18,649
Loans	51,961	44,411		49,970		47,251	56,229	65,788

Source: Company, Axis Securities Ltd

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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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