

QUARTER UPDATE

KARNATAKA BANK LTD



BUY | CMP 115 | TARGET 135 | POTENTIAL UPSIDE 18%

23 FEBRUARY 2019

Stock Data

M.Cap (₹ in cr)	3242
Equity (₹ in cr)	282.61
52 wk H/L ₹	92.3/137.05
Face Value ₹	10
Div. Yield	2.63%
NSE Code	KTKBANK
BSE Code	532652

LEAD RATIONALE

Company has successfully surpassed **landmark achievement of ₹117102 crore business turnover in Q3** by posting a healthy **CD ratio of 79.8%**, this has been backed by **impressive growth of 24.38% in operating profit**. Company continue to focus on **sustaining the momentum by ensuring credit quality with special focus on retail and mid - corporate sector and also by strengthening the liability side.**

Valuation Data

P/E	7.59
EV/EBITDA	14.77
P/BV	0.55
BV	206.13

Asset quality stable but provisions remained elevated

Bank's GNPA's ratio improved by 21 Bps Q-O-Q and stood at 4.45% against 4.66 % in previous quarter while NNPA's flat at 3% on sequential basis during Q3 FY19. However, Gross NPA in absolute terms stood at ₹2346 crore and Net NPA at ₹1561 crore. In addition, Slippage ratio excluding IL&FS is 0.53% while including IL&FS it is 0.86%. Going forward, **bank expects fresh slippage ratio to be under control and below 0.5% in Q4FY2019**. Provisions for bad loans during the quarter increased 8.2 % sequentially and 6.4 % on year to ₹ 209 crore in quarter ended December 2018, but provision coverage ratio contracted to 57.2 % against 57.5 % Q-O-Q.

Index Detail

Sensex	35871.48
Nifty	10791.65
Index	A / S&P BSE 500

Moreover, **management expect slippages to be curtailed & bank will take concrete steps to improve its asset quality going ahead, maintaining GNPA ratio to around 4% and NNPA ratio below 3% by end March 2019.**

Key Financials (₹ in crores)

Particulars	Q3 FY 19	Q3 FY 18	Variation %	Dec. 18	Dec. 17	Variation %
Interest Income	1514.42	1332.24	13.67	4374.67	3980.71	9.90
NII	487.95	451.48	8.08	1424.24	1316.14	8.21
Oper. Profit	400.37	321.90	24.38	1125.58	997.84	12.80
PAT	140.41	87.38	60.69	415.51	314.61	32.07
EPS	4.97	3.09	60.69	14.70	11.13	32.07

Strong growth, steady NIMs - Enhance profitabil- ity

Bank has reported credit growth of 17% Y-O-Y and 4% sequentially to ₹ 51961 crore driven mainly by corporate credit. Of the total advances, agri portfolio is 15.56% (₹ 7200 crore) while NPA on this book is 0.4%. Additionally, its priority sector advances ratio stood at 47.44% as on Q3FY19. Deposits grew at 12.8% Y-O-Y, significantly lower than advances growth, despite this C/D at 79.8% remains at the comfortable level. However, NIM pressure due to interest income reversal restricted NII growth at 8% Y-O-Y .

Moreover, CASA share has gone down to 26.65% compared to 28.23% Y-O-Y & 27.08% Q-O-Q and management **expects it to grow to 29-30% over the next 2-3 years**. Retail Term Deposits are 71.35% of its total deposits. Going forward, **company expect deposits to lag credit growth but at the same time CASA will improve with management focus on increasing the retail book.**

Operating Perform- ance

In the quarter gone by profitability has substantially improved largely due to higher other income growth of 55% Y-O-Y. It has reported PAT of ₹ 140 crore in Q3FY19 vs. ₹87.38 crore in the corresponding quarter of last fiscal year, **there by registering a growth of 60.69% on yearly basis**. On a Q-O-Q basis, the **net profit grew by 26%**. Operating profit during Q3 stood at ₹ 400 crore , registering a growth of 24% on year basis. Further, bank has posted 14.1% growth in the fee income while trading income jumped to ₹107 crore in Q3FY2019.

Looking ahead, growth rate, asset quality and earnings have shown consistent tractions. Bank has been able to maintain the consistency without any negative surprises and is determined to further consolidate it going forward .

Key Takeaways to watch out

⇒ Business Turnover of ₹ 1,30,000 crore.

⇒ Opening of 35 new Branches taking total no. of Branches to 835.

⇒ Bank expects to maintain **NIM above 3% by end March 2019.**

⇒ **Aiming to achieve ROA of above 1% by FY 2020.**

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⇒ Focus is on growing **balance sheet 2 times every three years**

⇒ Bank has **exposure of 15.2% of total advances in the NBFCs segment, while it has stopped taking further exposure in the NBFC sector.**

⇒ Major focus on the bank would be on MSME loans with ticket size of below ₹ 5 crore

⇒ MSME account under RBI dispensation stood at ₹ 225 crore ended December 2018. Further, bank expects **about 55-60% of these accounts to be upgraded.**

⇒ Bank has raised ₹ 400 crore under Tier 2 capital at a coupon rate of 12% per annum. The **bank expects increase in capital adequacy ratio to 12.8% including profit for 9MFY2019.**

⇒ In last two years company have seen more momentum with regards to farm loan waivers. Agriculture forms 17 % of the book and about ₹ 500 crore of agriculture loans fall in farm loan waiver for Karnataka state. However, company **expects no major exposure to agriculture book in Chhattisgarh and Madhya Pradesh as of now.**

Outlook and Valuation

As per the bank, slow growth of NBFCs is likely to continue and in a way, is proving to be positive for the banking industry. Further, in terms of the credit growth, for the bank as well as the industry, MSME sector is likely to be the growth engine going forward .

Loan book is improving both quantitatively and qualitatively as evidenced from improved CD Ratio, decreasing slippage ratio, declined GNPA & NNPA ratios, improved operational profit and improved NII. **With sustained credit growth, improved earnings, declining stress in book and CASA target of 29% are positives , bank should be able to wither provision pressure and further consolidate its position in the ensuing quarter.** Therefore, we recommend to **BUY with initial target of ₹ 135 giving an upside potential of 15%**

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