

KARNATAKA BANK

BANKING

Q4FY19: Mixed performance

Karnataka Bank (KBL) reported mixed performance. NII declined 11% on NIM contraction to 2.9%. Slippage for the quarter was elevated at Rs 444cr QoQ but underlying non-recognised stress has declined which could lead to lower stress additions in the coming quarters. Staff cost jumped ~43% YoY due to provisions made due to wage revision leading to PPOP decline of 32% YoY. However, lower provisions helped rake in better PAT YoY of Rs 62cr.

Outlook

Weaker margins and higher opex led to decline in KBL's operating profit in Q4. With most of the corporate-book stress already recognized, we expect the slippage run rate to ease. However, stress could arise from agriculture portfolio, since most of the concentration is in the home state which will be a key monitrable. Controlled provisioning is a key positive for the bank although higher opex and lower provision coverage remain negatives. However, the stock is quoting at attractive valuations of ~0.5x FY21E ABV and we retain BUY on KBL with TP of Rs 130 (0.6x FY21E ABV).

BUY

Target Price: Rs 130
CMP : Rs 113
Potential Upside : 14%

MARKET DATA

No. of Shares : 28.27cr
FV (Rs) : 10
Market Cap : Rs 3,207.8 cr
52-week High / Low : Rs141 / Rs93
Avg. Daily vol. (6mth) : 6,26,716 shares
Bloomberg Code : KBL IN
Reuters Code : KBNK.BO
BSE Code : 532652
NSE Code : KTKBNK

Key Highlights

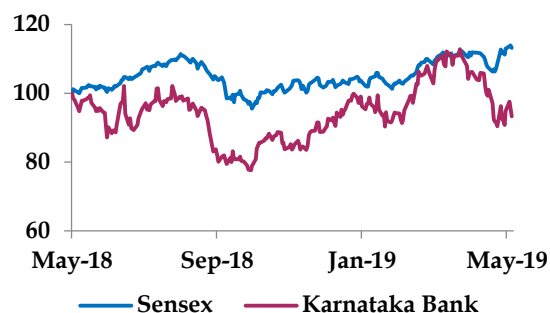
- Loan growth led by corporate:** Loan growth at 16% YoY was mainly led by large corporate/ housing loans, up ~55/35% YoY. Focus from hereon will be towards the retail / SME / mid-corporate segments (below ticket size of Rs15cr). Also, externally rated portfolio has further improved to 37.5% (vs 36.3 QoQ) with the proportion of A and above too improving to 28.7% (vs 27% QoQ). Share of large corporate has gone up to 48.7% from 47.7% QoQ while retail share has come down to 42.8% from 43.7% QoQ. We expect loan growth to be in 16-18% range over FY20-FY21E.
- CASA pick-up:** CASA share which had been gradually coming down in the last couple of years has gradually inched up to 28.07%. Management has envisaged improved CASA focus through separate CASA sales team, new and differentiated SA product and CASA target of 30%. Further, share of retail loans is expected to rise going forward upon overhauling of retail lending processes with system-wide implementation.

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)	(%)	(%)
FY18	1,858	326	11.5	(28.1)	191	9.9	0.59	2.96	132	0.9	7.1	0.5
FY19	1,905	477	16.9	46.6	214	6.7	0.53	2.95	177	0.6	8.5	0.6
FY20E	2,269	594	21.0	24.5	225	5.4	0.50	2.75	189	0.6	10.9	0.7
FY21E	2,816	896	31.7	50.9	256	3.6	0.44	2.30	220	0.5	12.7	0.8

Source: Company; Axis Securities

PRICE PERFORMANCE


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Key Highlights (Cont'd)

- **Slippages spike:** Restructured accounts has come down to Rs 298cr (MSME -Rs 118cr, Agri - Rs 60cr) as of FY19 from Rs 1,037cr in FY17. Further, SMA2 balance has come down to Rs 168cr from Rs 334cr in Q3FY19. NBFC portfolio, which forms ~15% of advances, has 98.2% proportion rated A or higher. Provision on IL&FS exposure, which is 28 bps of loan book, now stands at 54%. Exposure to other recently stressed corporate accounts is controlled with exposure to DHFL - 41 bps, Reliance ADAG - 31 bps and nil to Jet Airways and Essel Group. Management also guided that slippage ratio for FY20 would be contained within 2-2.5%.
- **NII de-growth:** NIM contracted 67/54 bps YoY/QoQ primarily on account of increase in share of large corporate loans, wherein there has been focus on highly rated clients. Share of large corporate loans has increased 250 bps YoY to 48.7% of total loans. Share of externally rated credit portfolio rose from 69% as of Q4FY18 to 77% as of Q4FY19. Management stated that material upward re-pricing of loans still lies ahead since 67% of performing advances are MCLR-linked, of which 77% are linked to 1-year MCLR. MCLR has evolved from 8.75% to 9.4% over the course of the year. We expect NIM to improve over FY20-FY21E on repricing and improving share from higher yield loans especially MSME loans.
- **Increase in C-I:** KBL has made provisions for 10% wage hike to employees offered by IBA. C-I ratio for FY19 jumped to 50.1% due to impact of this wage revision. We expect that operating expenses may remain elevated in FY20-21E given that wage negotiations are still underway and bank's focus on branch expansion outside of Karnataka. For FY20E the bank has guided to add 24 branches. Management is targeting a cost to income ratio of 45-50%. Digital lending for housing, personal, auto and MSME loans is on the anvil and such digitization is expected to bring down personnel requirement significantly with management stating that the count of 120 loan officers disbursing home loans could come down to 20-25 eventually. Share of non-branch transactions continued to rise rapidly, with the share rising to 78% in FY19 compared with 65% in FY18.

Results Update

	Mar-19	Mar-18	% YoY	Dec-18	%QoQ	FY19	FY20E	FY21E
Interest Income	1,531	1,443	6.1	1,514	1.1	5,906	6,910	8,223
Interest Expenses	1050	902	16.5	1026	2.3	4,001	4,641	5,476
Net Interest Income	481	542	-11.2	488	-1.4	1,905	2,269	2,747
Other Income	291	295	-1.3	301	-3.6	1,002	1,182	1,395
Total Income	771	836	-7.7	789	-2.3	2,907	3,451	4,142
Operating Expenses	447	361	24.0	389	15.0	1,457	1,710	1,993
Employee	203	142	43.5	181	12.6	606	739	887
Others	244	219	11.4	208	17.1	852	971	1,107
Operating Profits before provisions	324	475	-31.8	400	-19.0	1,450	1,742	2,148
Total Provisions	218	542	-59.8	209	4.2	842	926	991
PBT	107	-66	-260.3	191	-44.4	608	815	1,157
Taxes	45	-77	-157.8	51	-0.1	131	204	289
PAT	62	11	461.2	140.41	-56.0	477	612	868
EPS	2.2	0.4		5.0		16.9	21.6	30.7
Asset Quality								
GNPA Rs. Cr	2,456	2,376		2,346		2,456	2,671	3,002
NNPA Rs. Cr	1,617	1,401		1,561		1,617	1,749	1,726
GNPA %	4.4	4.9		4.5		4.4	4.2	4.0
NNPA %	3.0	3.0		3.0		3.0	2.8	2.3
Slippage Ratio %	3.2	8.8		3.1		2.8	2.5	2.3
Credit Cost %	1.6	4.6		1.6		1.5	1.5	1.3
Ratios %								
Cost to Income ratio	58.0	43.1		49.3		50.1	49.5	48.1
Loan/Deposit	80.1	75.2		79.8		80.1	80.8	82.2
CASA %	28.1	28.0		26.7		28.1	28.5	29.0
RoA %	0.6	0.1		0.7		0.6	0.7	0.8
RoE %	8.5	0.8		9.9		8.5	10.9	12.7
CAR (Basel III) %	13.2	12.0		12.0		13.2	11.5	11.0
Margins %								
Yield on Advances	9.3	9.8		9.4		9.2	9.5	9.6
Cost of Deposits	6.0	6.1		6.0		5.8	5.8	5.8
Quarterly NIMs	2.9	3.5		3.4		2.8	3.0	3.2
Balance sheet								
BV	205	191		202		205	221	252
Adjusted Networkth	4,168	4,010		4,162		4,168	4,516	5,407
Adj. BV	147	142		147		168	185	216
Balance sheet								
Capital	283	283		283		283	283	283
Net Worth	5,785	5,410		5,723		5,785	6,265	7,133
Deposits	68,452	62,871		65,141		68,452	78,720	91,315
Investments	16,185	15,444		15,700		16,185	18,613	21,405
Loans	54,828	47,252		51,961		54,828	63,601	75,049

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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