

Karnataka Bank

20 January 2020

Reuters: KBNK.BO; Bloomberg: KBL IN

Envisage weak credit growth for FY20, NPAs likely peaking out

Karnataka Bank (KBL) reported 3QFY20 results with the key pointers being: (1) Asset quality weakens further, provisioning stays elevated (2) Corporate book declines; focus remains on mid-corporate and retail (3) NIM was flat QoQ at 2.83%; expect improvement going forward (See comprehensive conference call takeaways on page 2 for *significant incremental colour*.) Per se, on the key P&L items, KBL posted 4% NII growth YoY at Rs5,078mn, PPOP growth of 25% YoY at Rs5,018mn and PAT decline of 12% YoY at Rs1,231mn. We have revised our estimates for FY20/FY21/FY22 and retained Buy rating on KBL, retaining our target price of Rs87 and valuing the stock at 0.4x H1FY22E P/BV.

Asset quality weakens further, provisioning stays elevated: Slippages during the quarter were Rs6.38bn (~5% annualized slippage ratio). NBFC sector slippages were Rs2.47bn, MSME slippages were Rs0.58bn and Agri slippages were Rs0.81bn. A hospitality account accounted for Rs0.18bn and slippages from residential builders sub-sector were Rs0.18bn. Of the total reductions of Rs4.54bn, Rs3.27bn (72% of total) were due to write-offs. PCR on the current stock of NPAs stands at 25% (excl. w/o), which we believe is low. For the quarter, provisioning was Rs31.47bn (+51% YoY, +20% QoQ), translating into annualized credit costs of 2.3% (+68bps YoY, +35bps QoQ). Given that the management is aiming for a PCR of 60% (incl. w/o) in the near term and presumably higher by end-FY21, we think that the provisioning run-rate will continue to be high and keep profitability under pressure. We have raised our credit costs estimates for FY20. Although, the management has guided that Q4FY20 run-rate could be lower sequentially. In the large corporate segment, infra exposure worth Rs1.5bn is stressed and under monitoring. Bank's residual NBFC exposure consists of good quality names (incl. PSUs) which continue to service interest regularly. Exposure to a coffee plantation account is Rs1.53bn, which is 100% secured by way of collateral and interest on this is being serviced duly.

Corporate book declines; focus remains on mid-corporate and retail: Overall credit growth was weak at 5.7% YoY, however, the management remains hopeful of achieving double-digit growth in FY21. Given the current environment and the bank's competitive positioning, we are building in 5%/8% growth in FY20/FY21. During the quarter, retail advances grew by 12.6% YoY, mid-corporate advances grew by 10.5% YoY and corporate advances declined by 9.51% YoY. Current growth rates in the retail and mid-corporate segment are expected to be sustained as the bank works towards achieving its target portfolio mix of 50% retail, 30% mid-corporate and 20% large corporate. To push retail growth, the bank has taken various measures such as employing regional sales executives in all 14 regional offices, initiating digital sanctioning of home, auto and personal loans (to be extended to MSME too in a month's time).

NIM was flat QoQ at 2.83%; expect improvement going forward: Drop in cost of deposits due to lower TD rates and higher CASA ratio should be instrumental in achieving higher NIMs going forward. Bank expects to achieve 3% NIM by FY21. Further, FY21 ROA guidance of 0.9-1.0% factors in better loan book composition.

Valuation and outlook: We have revised our NII estimates by -2.2%/-7.2%/-9.8%, PPOP estimates by 11.9%/-8.7%/-7.7% and PAT estimates by 1.7%/-11.8%/8.3% for FY20/FY21/FY22, respectively. We have retained Buy rating on KBL, retaining our target price of Rs87, valuing the stock at 0.4x H1FY22E P/BV.

BUY

Sector: Banking

CMP: Rs75

Target Price: Rs87

Upside: 16%

Raghav Garg, CFA

Research Analyst

raghav.garg@nirmalbang.com

+91-22-6273 8192

Arjun Bagga

Research Associate

arjun.bagga@nirmalbang.com

+91-22-6273 8111

Key Data

Current Shares O/S (mn)	282.6
Mkt Cap (Rsbn/US\$m)	21.2/298.1
52 Wk H / L (Rs)	141/68
Daily Vol. (3M NSE Avg.)	879,021

Price Performance (%)

	1 M	6 M	1 Yr
South Indian Bank	4.8	(24.6)	(38.0)
Nifty Index	1.5	5.7	13.3

Source: Bloomberg

Y/E Mar (Rsmn)	Q3FY20	Q3FY19	Q2FY20	YoY (%)	QoQ (%)
Interest Income	16,216	15,144	16,296	7.1	(0.5)
Interest Expenses	11,138	10,265	11,309	8.5	(1.5)
Net Interest Income	5,078	4,880	4,987	4.1	1.8
NIM (%)	2.83	2.94	2.82	-11 bps	1 bps
Non Interest Income	4,021	3,014	3,088	33.4	30.2
Total Income	9,099	7,893	8,075	15.3	12.7
Staff Cost	1,865	1,808	1,632	3.2	14.3
Other Op Exp	2,216	2,082	2,309	6.5	(4.0)
Total Operating Expenses	4,081	3,890	3,941	4.9	3.6
Cost to Income (%)	44.9	49.3	48.8	-443 bps	-395 bps
Pre-Provisioning Operating Profit	5,018	4,004	4,134	25.3	21.4
Provisions	3,147	2,090	2,624	50.6	19.9
PBT	1,871	1,914	1,510	(2.2)	23.9
Tax	640	510	451	25.5	41.7
-effective tax rate	34.2	26.6	29.9	755 bps	431 bps
PAT	1,231	1,404	1,059	(12.3)	16.3
EPS (Rs)	4.4	5.0	3.7	(12.3)	16.3
BV (Rs)	217.0	202.5	210.4	7.2	3.1
Deposits	713,560	651,410	701,897	9.5	1.7
Advances	549,110	519,610	534,684	5.7	2.7

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Comprehensive Analyst Meet Takeaways

Asset quality

- Total slippages of Rs 6.38bn during the quarter consisted of:
 - NBFC sector slippages: Rs2.47bn
 - MSME slippages: Rs0.58bn
 - Agri slippages: Rs0.81bn
 - Hospitality: Rs0.18bn
 - Residential builders: Rs0.18bn
- The bank has guided for FY20 PCR of 60%.
- SMA2 stands at Rs4.79bn (vs Rs5.88bn QoQ)
- Security receipts outstanding are at Rs3.9bn. PCR on SRs is 21.4%.
- Restructured standard advances stood at Rs5.04bn.
- The bank has provided as per IRAC norms for the 4 stressed NBFC accounts. The bank's exposure to NBFCs stands at 14% of total loan book, consisting of companies with good promoters and govt backed entities. The bank does not expect any stress from the residual NBFC exposure.
- NBFC exposure for the bank has come down. The bank has been careful in terms of disbursing loans of more than Rs 1bn.
- Of the total NBFC exposure, 20-21 accounts are above Rs1bn.
- Rating category wise SMA2 o/s:
 - D rated: Rs0.73bn
 - C rated: nil
 - B rated: nil
 - BB rated: Rs0.10bn
 - BBB: nil
 - Total BBB and below: Rs0.83bn
- The bank expects 4QFY20 slippages to be lower sequentially.
- The total exposure to IBC accounts stands at Rs12.85bn, which are provided to the extent of Rs10.49bn. The bank is further strengthening provisions on these accounts and expects writebacks on resolution of the same.
- The bank has fully provided for the IL&FS loan exposure and Rs0.25bn investment exposure.
- Resolution of a Rs0.69bn IBC account is expected by March'20. The bank does not expect any haircut on this.
- As per the bank, corporate book stress is fully recognized. Apart from Rs1.5bn infra sector account, the bank sees no corporate book stress. The infra account is being monitored.
- The bank has Rs1.53bn exposure to a coffee plantation account with 100% collateral security. The account has been servicing its loan obligations. The account is being monitored and is not expected to turn stressed going forward.
- Most of the migration provisions have been upfronted in 3Q and hence 4Q could be lighter in terms of provisions.
- Bank has guided for FY21 NNPA's of 3%.

Loan and business growth

- During the quarter, retail advances grew by 12.62%, mid-corporate advances grew by 10.48% while corporate loans declined by 9.51%. The bank expects to be able to sustain the growth in mid corporate and retail portfolios.
- During the quarter, the bank started digital sanctioning of home, auto and personal loans. The bank plans to extend the same to MSME portfolio as well within a month. Going digital has helped the bank bring down time of loan processing from 7 days to 20 mins. (excluding valuation and legal opinion)
- The bank reiterated its guidance of achieving a retail/mid corporate/corporate mix of 50%/30%/20% by FY21.
- To push the retail loan growth, bank has employed regional sales executives in all 14 regional offices.
- The bank has 246 accounts with exposure above Rs1bn. The total outstanding in these accounts is Rs 140.21bn.
- The reduction in corporate loans was mainly due to recoveries. Also, the bank requested for advance repayments from some NBFCs which were fulfilled. There was no sell down of loans.
- As per the bank, average tenure for existing corporate book is 24-25 months. Only PSU entities like NTPC are given loans for 5-10yrs whereas loans for other entities are given for shorter periods.
- The bank has guided for FY21 credit growth of 14-15%. However, the credit growth would also depend on the economy.

Margin, Liabilities and Liquidity

- The bank has guided for FY20 NIM of 2.8%-2.9%. FY21 NIM guidance stands at 3%.
- The bank expects cost of deposits to moderate going forward because of reduction in TD rates and growth in CASA.
- As per the bank, improvement in RoA is expected because of better operational efficiencies due to shift in advances portfolio composition.
- FY21 guidance for RoA is 0.9-1.0% and RoE is 12%.

Fee and Other Income

- Increasing retail loan book share would help augment the bank's fee income by providing cross sell opportunities.
- Majority of the treasury profit has come from sale of HTM securities.

Operating Expenses

- The bank has fully provided for a 12% IBA wage revision.
- As per the bank, it is evaluating the decision regarding opting for lower tax rates. The decision needs to be taken during the current year or the next year.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net interest income	18,577	19,051	19,968	21,813	24,253
Pre-provisioning operating profit	14,732	14,498	16,402	15,518	17,561
PAT	3,511	4,997	5,186	5,693	8,000
EPS (Rs)	12.4	17.7	18.3	20.1	28.3
BV (Rs)	191.4	204.7	219.2	235.6	260.1
P/E (x)	6.0	4.2	4.1	3.7	2.6
P/BV (x)	0.4	0.4	0.3	0.3	0.3
Gross NPAs (%)	4.9	4.4	5.0	4.9	4.6
Net NPAs (%)	3.0	3.0	2.7	2.0	1.2
RoA (%)	0.5	0.7	0.6	0.6	0.8
RoE (%)	6.7	8.9	8.7	8.9	11.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	Q3FY20	Q3FY19	Q2FY20	YoY (%)	QoQ (%)	Q3FY20E	Devi. (%)
Net interest income	5,078	4,880	4,987	4.1	1.8	4,952	2.5
Pre-provisioning operating profit	5,018	4,004	4,134	25.3	21.4	4,035	24.3
PAT	1,231	1,404	1,059	(12.3)	16.3	1,510	(18.5)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			% Revision		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net Interest Income (Rs mn)	19,968	21,813	24,253	20,420	23,504	26,877	(2.2)	(7.2)	(9.8)
NIMs (%)	2.7	2.7	2.7	2.7	2.7	2.8	0 bps	-5 bps	-7 bps
Operating Profit (Rs mn)	16,402	15,518	17,561	14,661	16,995	19,026	11.9	(8.7)	(7.7)
Profit after tax (Rs mn)	5,186	5,693	8,000	5,098	6,454	7,385	1.7	(11.8)	8.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Interest income	54,238	59,060	64,555	70,052	76,432
Interest expenses	35,661	40,008	44,587	48,239	52,179
Net interest income	18,577	19,051	19,968	21,813	24,253
Fees	3,644	4,305	5,058	5,389	5,876
Other income	5,900	5,715	7,401	5,171	5,656
Net revenues	28,120	29,071	32,427	32,372	35,785
Operating expenses	13,388	14,573	16,025	16,855	18,224
-Employee expenses	5,248	6,056	7,146	7,574	8,105
-Other expenses	8,140	8,517	8,879	9,280	10,119
Pre-prov operating profit	14,732	14,498	16,402	15,518	17,561
Provisions	11,376	8,195	9,920	8,401	7,560
-Loan loss provision	10,549	7,922	9,888	8,313	7,461
-Provisions for investment	977	282	32	88	99
-Other provisions	(151)	(8)	0	0	0
PBT	3,356	6,303	6,482	7,116	10,001
Tax	(155)	1,306	1,296	1,423	2,000
PAT	3,511	4,997	5,186	5,693	8,000

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity capital	2,826	2,826	2,826	2,826	2,826
Reserves & surplus	51,275	55,026	59,133	63,748	70,671
Shareholder's funds	54,102	57,852	61,959	66,575	73,497
Deposits	628,713	684,521	739,283	802,122	882,334
Borrowings	8,160	33,255	41,569	41,569	43,647
Other liabilities	12,763	14,829	18,120	18,850	19,512
Total liabilities	703,737	790,458	860,931	929,115	1,018,991
Cash/equivalent	36,010	36,097	48,934	52,849	58,134
Advances	472,518	548,282	575,696	621,752	683,927
Investments	154,444	161,850	190,568	207,185	227,904
Fixed assets	7,616	7,750	8,525	9,377	10,315
Other assets	33,149	36,478	37,208	37,952	38,711
Total assets	703,737	790,458	860,931	929,115	1,018,991

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

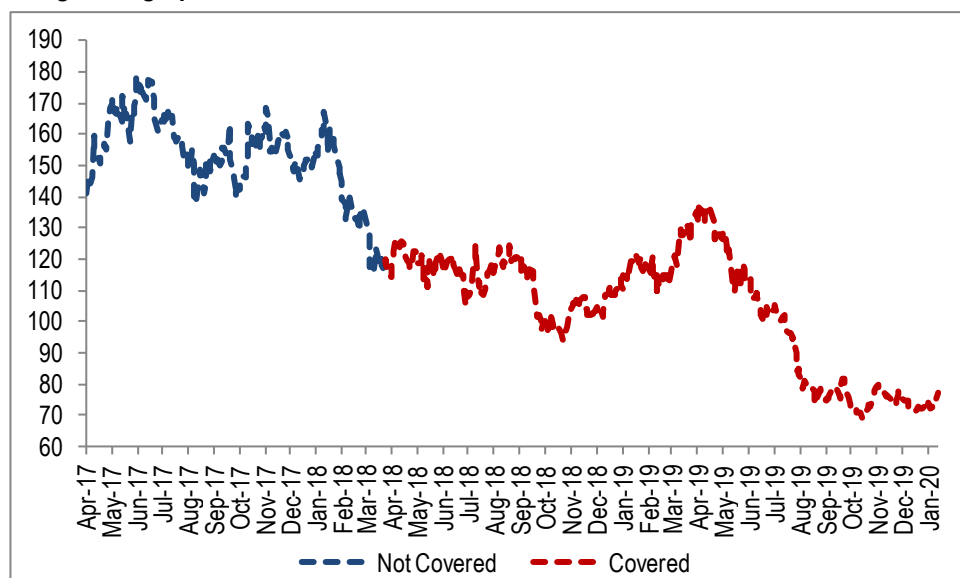
Ratio's	FY18	FY19	FY20E	FY21E	FY22E
Growth (%)					
NII growth	24.6	2.6	4.8	9.2	11.2
Pre-provision profit growth	47.9	-1.6	13.1	-5.4	13.2
PAT growth	-18.3	42.4	3.8	9.8	40.5
Business (%)					
Deposit growth	10.8	8.9	8.0	8.5	10.0
Advance growth	28.0	16.0	5.0	8.0	10.0
Business growth	17.6	11.9	6.7	8.3	10.0
CD	75.2	80.1	77.9	77.5	77.5
CASA	28.0	28.1	28.3	29.0	29.9
Operating efficiency (%)					
Cost-to-income	47.6	50.1	49.4	52.1	50.9
Cost-to-assets	2.0	2.0	1.9	1.9	1.9
Spreads (%)					
Yield on advances	9.7	9.2	9.1	9.1	9.1
Yield on investments	6.5	7.0	6.7	7.0	7.0
Cost of deposits	5.8	5.8	5.8	5.8	5.8
Yield on assets	8.9	8.8	8.6	8.6	8.6
Cost of funds	5.9	5.9	6.0	5.9	5.9
NIMs	3.1	2.8	2.7	2.7	2.7
Capital adequacy (%)					
Tier I	11.3	11.2	11.0	10.9	10.7
Tier II	0.8	2.0	1.3	1.3	1.3
Total CAR	12.0	13.2	12.3	12.3	12.0
Asset Quality (%)					
Gross NPA	4.9	4.4	5.0	4.9	4.6
Net NPA	3.0	3.0	2.7	2.0	1.2
Specific Provision coverage	39.8	33.0	47.0	60.8	75.6
Slippage	5.0	2.8	2.9	2.3	2.0
Credit-cost	2.6	1.5	1.7	1.4	1.2
Return (%)					
ROE	6.7	8.9	8.7	8.9	11.4
ROA	0.5	0.7	0.6	0.6	0.8
RORWA	0.8	1.1	1.0	1.1	1.3
Per share					
EPS	12.4	17.7	18.3	20.1	28.3
BV	191.4	204.7	219.2	235.6	260.1
ABV	140.8	146.5	163.9	192.0	231.7
Valuation					
P/E	6.0	4.2	4.1	3.7	2.6
P/BV	0.4	0.4	0.3	0.3	0.3
P/ABV	0.5	0.5	0.5	0.4	0.3

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	117	147
17 May 2018	Buy	116	150
13 July 2018	Buy	115	155
9 October 2018	Buy	99	141
15 October 2018	Buy	98	149
14 January 2019	Buy	116	143
8 April 2019	Buy	137	160
16 May 2019	Buy	111	153
8 July 2019	Buy	103	119
16 July 2019	Buy	102	118
7 October 2019	Buy	72	84
16 October 2019	Buy	69	83
8 January 2020	Buy	72	94
20 January 2020	Buy	75	87

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010