

August 11, 2017

LKP Bytes

Karnataka Bank

Outperformer

LKP

Since 1948

Industry: Banking

Incorporated in the year 1924, Karnataka Bank Limited (KTK) is an old generation private sector bank headquartered at Mangalore in Karnataka. As on 30th June 2017, KTK has 769 branches and 1398 ATMs with a strong foothold in South India (77.6%) especially due to a dominant presence in Karnataka (61.5%). With the tagline "Your Family Bank. Across India", KTK offers a wide variety of corporate & retail banking products and services to over 8.9 mn customers. KTK has forayed into the General Insurance business as a JV partner in Universal Sompoo General Insurance with a 15% stake.

Advances

Led by a strong surge in advances towards the priority sector, KTK's loan book augmented to ₹ 370bn in FY17 (9.15% YoY) and further to ₹ 385bn in Q1FY18 (4% QoQ). In the backdrop of subdued credit offtake experienced by banks, KTK has resisted the uncertainties and maintained a satisfactory trajectory of growth in advances. The market share of KTK in loans and advances was 0.48% and lending under various socio-economic schemes has shown decent progress. A positive outlook in the economic scenario along with an improvement in manufacturing & service sector performance will ensure credit expansion. KTK aims to push retail loan segment by holding housing & car loan campaigns and the government's inclusive growth agenda may also bring additional credit requirements.

Deposits

Due to the DeMon exercise undertaken by the central government in Q3FY17, KTK's CASA expanded 24.23% YoY in FY17 to ₹ 164.73bn and CASA as a share of deposits increased 277bps to 29.04%. Aided by the CASA growth, deposits augmented from ₹ 504.88bn in FY16 to ₹ 567.33bn in FY17. However in Q1FY18, deposits decreased slightly to ₹ 562.88bn and CASA declined to ₹ 162.71bn consequently reducing its share of deposits by 33bps to 28.94%. With an objective of growing low cost CASA, KTK is resorting to aggressive marketing and CASA campaigns in order to reach out to new clients. To increase the market share in terms of deposit, KTK has been increasingly focusing on customer base enlargement, increasing branch network, competitive interest rates, new services and innovative technology.

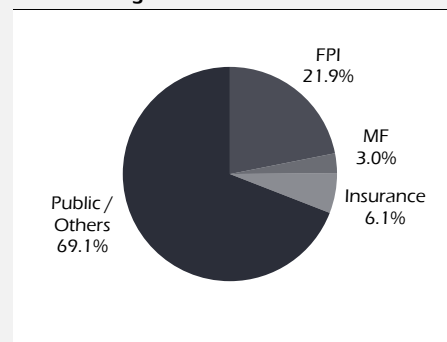
Net Interest Margin (NIM)

In FY17, Net interest margin of KTK remained stable at 2.44%. Resiliency in NIM can be attributed to decline in cost of funds which has been in tandem with the fall witnessed in yield on advances. The Credit to Deposit ratio has expanded to 68.40% in Q1FY18 (320bps QoQ) and together with sustained spreads, KTK has maintained an improving trajectory of NIM marking an increase of 47bps QoQ to 2.64% in Q1FY18. ALM mismatches have been low and there has been a strong bias towards retail funding which have kept the NIMs steady.

Stock Data

Current Market Price (₹)	138
12 month Target (₹)	180
Potential upside (%)	30
FV (₹)	10
Market Cap (₹ bn)	39
52-Week Range (₹)	181 / 100
Reuters / Bloomberg Code	KBNK.BO / KBL IN
BSE / NSE Code	532652 / KTKBANK

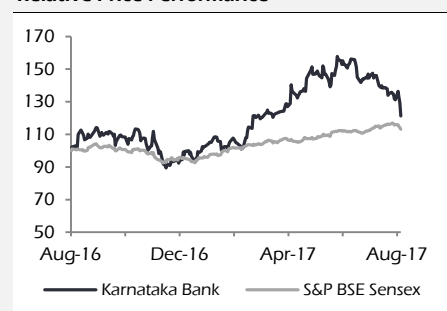
Shareholding Pattern



Key Operational Metrics

YE Mar	FY14	FY15	FY16	FY17
Total Business (₹ bn)	689	777	844	937
NIM (%)	2.4	2.4	2.4	2.4
C I Ratio (%)	56.1	50.0	57.0	53.4
Cost of Deposit (%)	7.9	7.87	7.51	6.73
Yield on Advances (%)	12.2	12.0	11.6	10.8
Gross NPA (%)	2.9	3.0	3.4	4.2
Net NPA (%)	1.9	2.0	2.4	2.6
Return on Assets (%)	0.7	0.9	0.8	0.7
Return on Equity (%)	10.5	14.0	11.7	10.2
CASA (%)	25.4	24.9	26.3	29.0
ABV (₹)	162	180	196	182

Relative Price Performance



Girish Shenoy
girish_shenoy@lkipsec.com
+91 22 6635 1232

LKP Research

Asset Quality

In view of continuing slowdown in the economy and delinquencies in select sectors, KTK's Gross NPA and Net NPA increased to 4.21% (77bps YoY) and 2.64% (29bps YoY) respectively in FY17. Both further increased to 4.34% (13bps QoQ) and 3.20% (56bps QoQ) respectively in Q1FY18 indicating asset quality stress. On a positive note, Provision Coverage Ratio (PCR) has improved from 48.39% in FY16 to 54% in FY17. Over the years, the composition of the loan book has changed significantly in favour of retail advances thereby reducing the share of corporate segment which forms a substantial portion of stressed assets. Strengthening of credit quality initiatives, risk management practices and asset lending policies with a dedicated focus on reducing slippages will ensure improvement in asset quality

Profitability

Operating profit increased to ₹9.96 bn in FY17 (16.53% YoY) on account of a strong surge in other income which augmented to ₹8.09 bn (49.09% YoY) and an increase in NII to ₹ 14.91bn (1.88% YoY). In Q1FY18, operating profit declined to ₹3.09 bn (5.94% QoQ) due to a sharp decline in other income (30.25% QoQ). While the increase in NII was largely driven by drop in the interest cost and expansion in advances, sustainable transaction fees and treasury gains contributed to the sharp rise in other income. The Cost to Income ratio increased 302bps YoY to 56.7% in FY17 and 135bps QoQ to 51.75% in Q1FY18. Focus on increasing other income along with emphasis on continuous improvement of operating efficiency will assist improvement in Cost to Income ratio. In FY17, Return on Assets ratio and Return on Equity ratio declined 2bps YoY to 0.74% and 149bps YoY to 10.24% respectively while in Q1FY18, both ratios declined 2bps QoQ to 0.83% and 58bps QoQ to 10.25% respectively. The Capital Adequacy Ratio (CRAR) of the Bank, computed as per Basel III guidelines, stood at 13.30% as on 31st March 2017.

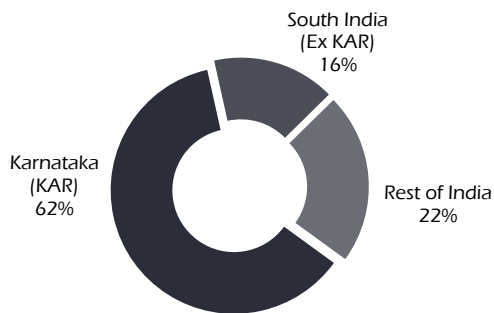
Outlook & Recommendation

Based on the prediction of normal monsoon and pick up in manufacturing activity, the economic scenario is on a verge of an improvement. Demographic shifts in terms of income levels and cultural shifts in terms of lifestyle aspirations are changing the profile of the Indian consumer which is regarded as a key driver of economic growth going forward. Government's focus on reviving the rural economy will support rural consumption demand more enduringly and may ultimately lead to increased opportunities for KTK. As per *KBL Vision 2020* document, KTK's deposits and advances are projected to increase to ₹1000bn and ₹ 800bn respectively by March 2020 besides recording significant improvement in key financial parameters. Moreover, KTK aims to become a preferred banker to at least 1% of India's population by March 2020. Owing to stable NIM, healthy CASA, attention to asset quality improvement and focus on improving profitability, KTK is a strong contender amongst its regional peers. At the current price of ₹138, KTK trading at 0.8x adjusted book value and 3% dividend yield can be **ACCUMULATED** with a **one year price objective of ₹180**.

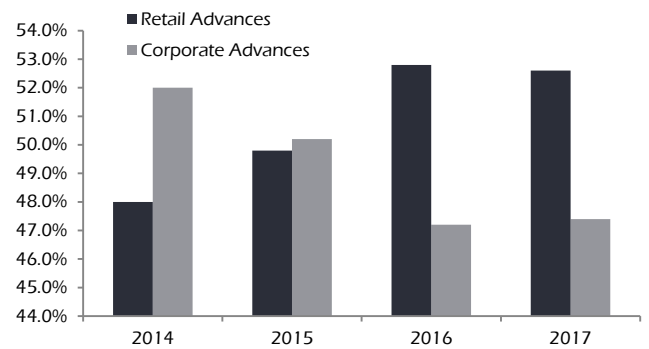
Financial Performance

Particulars (₹ mn)	FY17	FY16	YoY Chg (%)	Q1FY18	Q4FY17	QoQ Chg (%)
Total Interest Earned (I)	51,854	49,922	3.9	13,305	12,945	2.8
Interest/ Discount on Advances/Bills	37,936	37,005	2.5	9,498	9,035	5.1
Income on Investments	12,982	11,899	9.1	3,326	3,502	(5.0)
Int. on balance with RBI & other interbank Funds	22	26	(15.8)	120	223	(46.3)
Others	992	992	0.0	361	185	95.2
Other Income (II)	8,093	5,429	49.1	2,174	3,117	(30.3)
Total Income (I) + (II)	59,947	55,351	8.3	15,479	16,062	(3.6)
Interest expended (III)	36,948	36,893	0.1	9,061	9,423	(3.8)
Operating Expenses (IV)	13,042	9,912	31.6	3,321	3,346	(0.7)
Employees Cost	6,010	4,430	35.7	1,374	1,227	12.0
Other Operating Expenses	7,031	5,482	28.3	1,947	2,119	(8.1)
Total Expenditure (III) + (IV)	49,989	46,805	6.8	12,382	12,769	(3.0)
Op.Profit before Provisions & Contingencies	9,958	8,545	16.5	3,097	3,293	(5.9)
Provisions (other than tax) & Contingencies	5,279	3,265	61.7	1,989	1,604	24.0
Profit (Loss) before tax	4,680	5,280	(11.4)	1,108	1,689	(34.4)
Tax expense	157	1,127	(86.1)	(230)	305	(175.5)
Net profit for the period	4,523	4,153	8.9	1,339	1,384	(3.3)

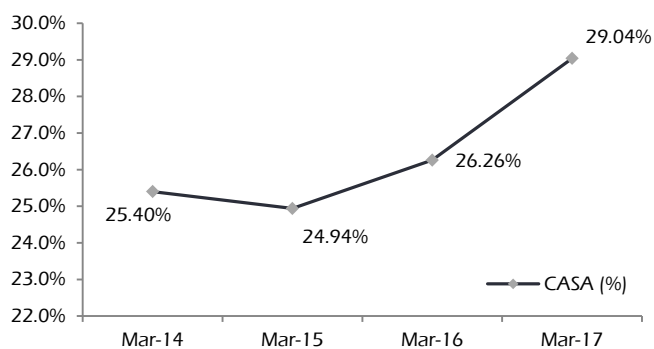
Branch Distribution



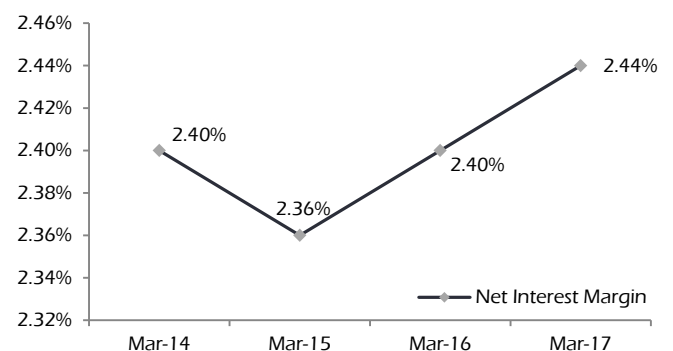
Break Up of Advances



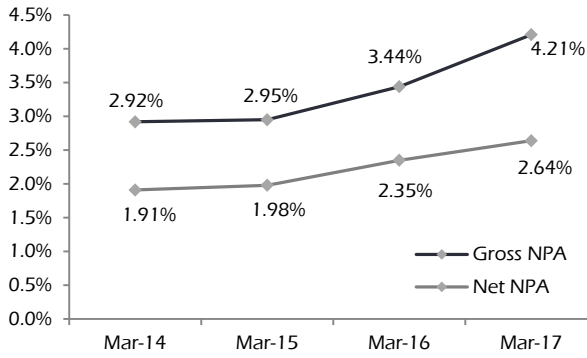
CASA



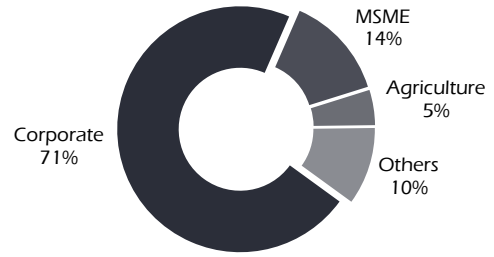
Net Interest Margin



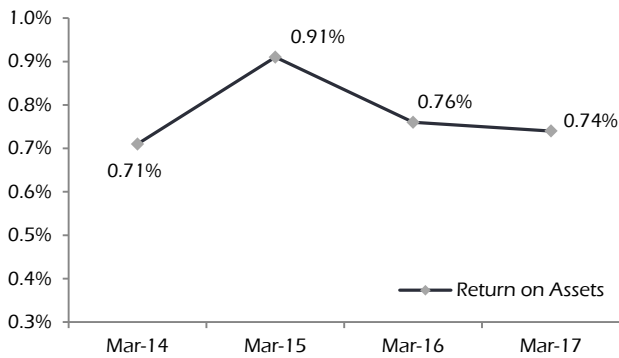
Gross NPA & Net NPA



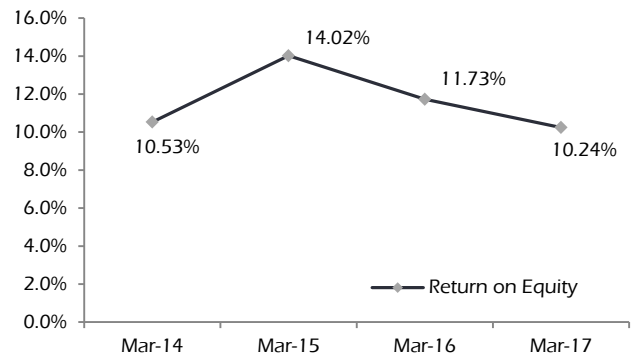
NPA Composition



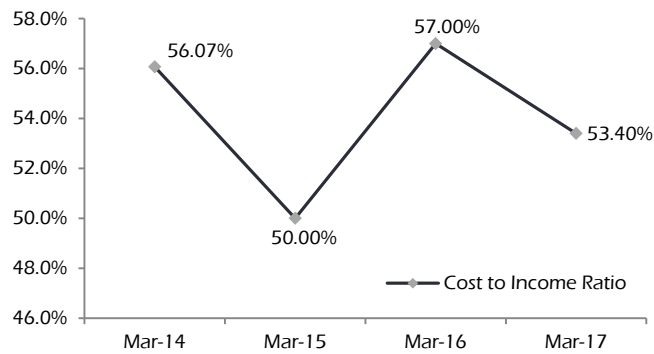
ROA



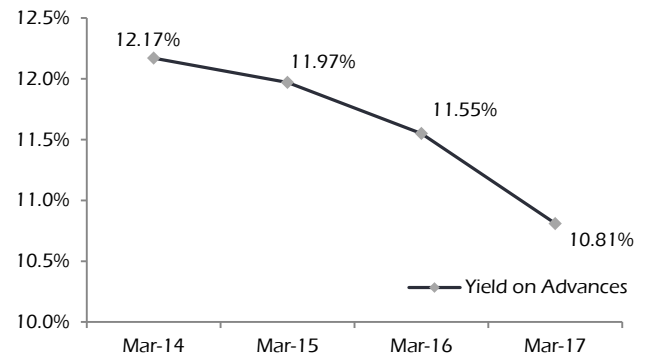
ROE



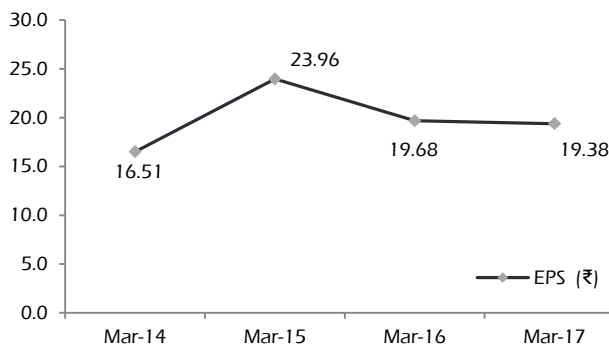
Cost to Income Ratio



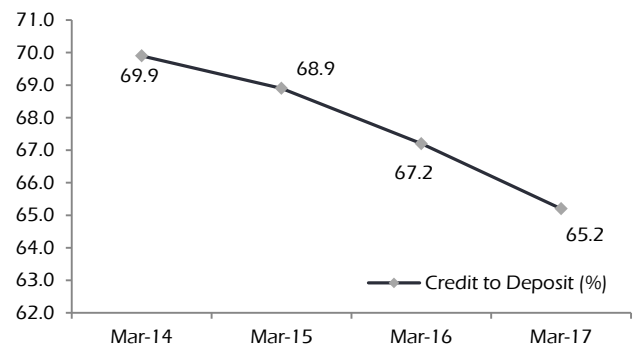
Yield on Advances



EPS (₹)



Credit to Deposit



Source: Company, LKP Research

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