

KARNATAKA BANK

BANKING

Q3FY18: Strong loan growth and profitability, albeit high credit costs

Karnataka Bank (KBL) reported a robust operational performance in Q3FY18 with 20%YoY jump in NII supported by NIMs (up 25bps) and loan growth (24% YoY). Rise in other income by 46% led to better PAT even as higher provisioning (though lower from Q2FY18) continued. Credit costs have been higher in the last couple of quarters (1.5% in Q3FY18). Asset quality improved on decline in G/NNPAs and lower slippage ratio of 0.5%. Capital position remains stable with Tier I of 11.1%.

Outlook

Q3FY18 results were strong, both balance sheet and profitability wise, reiterating the transformation journey that the bank has envisaged. Pressure on provisions will continue in the next couple of quarters. Loan growth is expected to be at ~25% with NIM sustaining at ~3%. Management focus is on getting 1% market share and growing balance sheet 2x every three years. High retail share (~47%) provides comfort. We retain our buy rating while adjusting for higher provisioning in FY18E and FY19E and assign P/ABV of 1.05x FY20E arriving at a target price of Rs 195/-.

Key Highlights

- Strong loan growth:** Focus on retail/corporate sectors led to 24% loan growth which was one of challenging areas for the bank in the last couple of years. CD ratio rose to 77% (highest in the last 17 yrs) from 62%YoY. Corporate borrowers with 'AAA' and 'AA' ratings constituted 7.5% and 7.7%, respectively, of the gross bank credit. Management has entailed loan growth target of 25% for FY18. For the next couple of years, we expect loan growth to be led by higher retail/pick-up in corporate and grow by ~24/20/18% in FY18/FY19/FY20E.
- NIMs improved:** Robust loan growth and NIM of 3.1%, (up 25/6bps YoY/QoQ) aided 20/3% YoY/QoQ NII growth to Rs 451cr. Non-interest income was up 46%YoY led by 32% increase in fee & treasury income. We expect NIM to sustain at +3% aided by higher CD ratio (~80%) in the near term, improving CASA and reduction in the RIDF portfolio.

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	2.6	147	1.0	10.2	0.7
FY18E	1,850	470	16.6	3.7	191	9.5	0.82	2.4	143	1.1	10.6	0.8
FY19E	2,165	492	17.4	4.8	209	9.0	0.75	1.8	165	1.0	13.1	1.0
FY20E	2,554	512	18.1	4.1	227	8.7	0.69	1.4	186	0.8	13.2	1.0

Source: Company; Axis Securities

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Quarterly Update

BUY

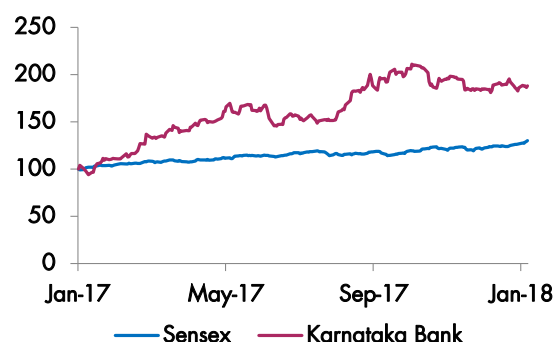
Target Price: Rs195

CMP : Rs157
 Potential Upside : 24%

MARKET DATA

No. of Shares : 28.27cr
 FV (Rs) : 10
 Market Cap : Rs 4,490 cr
 52-week High / Low : Rs181 / Rs112
 Avg. Daily vol. (6mth) : 7,99,971 shares
 Bloomberg Code : KBL IN
 Reuters Code : KBNK.BO
 BSE Code : 532652
 NSE Code : KTKBNK

PRICE PERFORMANCE



Key Highlights (Cont'd)

- **Improvement in asset quality sustained:** Sequentially G/NNPAs have gone down by 16/19bps to 3.97/2.85%. Slippages have moderated to Rs 211cr (0.5% annualized vs. 0.9% in Q2FY18). S4A/5:25/SDRs/SRs stood at Rs 347/170/182/450 cr. Restructured loans have come down to Rs 634cr (from Rs 934 in March '17) of which NPA have also declined to 11% of RAs (35% in March '17). We have built in stable asset quality (NNPA FY18E/FY19E/FY20E - 2.4/1.8/1.4%) with moderation in incremental slippages.
- **High provisioning prevails, though lower than Q2FY18:** Credit costs while down sequentially to 1.8% from 2.2%, is still higher than 1.1% a year ago. The bank is also preparing to implement IFRS which may lead to increase in provisions in the coming quarters but the timeline is not yet warranted. While we expect provisioning on incremental slippages to moderate, provisions for the next couple of quarters will increase with NPA ageing and balance provisioning towards NCLT cases.
- **Marginal decline in CASA:** CASA share has gone down to 28.2% vs. 30.2/28.6% YoY/QoQ. Retail Term Deposits are 71% of its total deposits. Proportion of NRI deposits have gone up from 6.1% to 6.2% YoY. We expect deposits to lag credit growth going forward but at the same time CASA share will improve further from 28% as management focuses on gaining market share.

Results Update

	Dec-17	Dec-16	% YoY	Sep-17	%QoQ	FY18E	FY19E	FY20E
Interest Income	1,332	1,324	1%	1,318	1%	5,810	6,798	8,021
Interest Expenses	881	947	-7%	878	0%	3,960	4,633	5,467
Net Interest Income	451	377	20%	440	3%	1,850	2,165	2,554
Other Income	195	134	46%	248	-21%	910	937	965
Total Income	646	510	27%	688	-6%	2,760	3,102	3,520
Operating Expenses	324	338	-4%	322	1%	1,361	1,568	1,790
Employee	121	177	-31%	124	-2%	556	651	735
Others	203	161	26%	198	3%	805	918	1,055
Operating Profits before provisions	322	172	87%	366	-12%	1,399	1,534	1,729
Total Provisions	196	101	95%	226	-13%	812	869	1,008
PBT	126	71	76%	140	-11%	587	665	721
Taxes	38	3	1291%	47	-19%	117	173	209
PAT	87	69	28%	93	-6%	470	492	512
EPS	3	2	28%	3	-6%	16.6	17	18
Asset Quality								
GNPA Rs. Cr	1,784	1,560	14%	1,716	4%	1,772	2,011	2,196
NNPA Rs. Cr	1,263	1,066	19%	1,247	1%	1,091	965	878
GNPA %	3.97	4.3		4.13		3.9	3.75	3.5
NNPA %	2.85	2.99		3.04		2.4	1.8	1.4
Slippages	211	267		374		1,545	1,609	1,757
Slippage Ratio %	0.48	0.75		0.91		3.4	3	2.8
Restructured Assets	970	1,330		1,028		1,000	800	500
Credit Cost %	1.8	1.1		2.2		1.79	1.62	1.6
Ratios %								
Cost to Income ratio	50.2	66.3		46.8		53.5	50.6	50.9
Loan/Deposit	76.9	62.3		72.7		65.2	66.4	68.8
CASA %	28.2	30.2		28.6		27.6	28	28.1
RoA %	0.7	0.7		0.7		0.8	1	1
RoE %	8	9.5		8.7		10.6	13.1	13.2
CAR (Basel III) %	12.3	13.2		12.5		12.8	12.5	12.8
Tier I %	11.1	11.9		11.4		12	11.7	11.8
Tier II %	1.1	1.3		1		0.8	0.8	1
Margins %								
Yield on Advances	10.1	11.1		10.2		11.1	10.8	10.9
Cost of Deposits	6.2	6.8		6.2		6.8	6.5	6.6
Quarterly NIMs	3.1	2.8		3		2.45	2.5	2.6
BV	201	165	22%	187	7%	191	209	227
Adjusted Networth	4,420	3,599	23%	4,043	9%	4,044	4,661	5,260
Adj. BV	156	127	23%	143	9%	143	165	186

Balance sheet

Capital	283	283		283		283	283	283
Net Worth	5,683	4,665	22%	5,290	7%	5,134	5,626	6,138
FV	10	10		10		10	10	10
Deposits	57,771	57,435	0.60%	56,558	2%	66,050	78,600	91,176
Investments	15,695	18,250	-14%	16,734	-6%	23,050	26,278	30,220
Loans	44,411	35,786	24%	41,127	8%	45,448	53,629	62,746

Source: Axis Securities Ltd

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BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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